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**SOAH DOCKET NO. 473-21-0538  
DOCKET NO. 51415**

<b>APPLICATION OF SOUTHWESTERN</b>	<b>§</b>	<b>BEFORE THE STATE OFFICE</b>
<b>ELECTRIC POWER COMPANY FOR</b>	<b>§</b>	<b>OF</b>
<b>AUTHORITY TO CHANGE RATES</b>	<b>§</b>	<b>ADMINISTRATIVE HEARINGS</b>

**SOUTHWESTERN ELECTRIC POWER COMPANY’S  
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

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**SOAH DOCKET NO. 473-21-0538  
DOCKET NO. 51415**

<b>APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES</b>	<b>§ § §</b>	<b>BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS</b>
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**SOUTHWESTERN ELECTRIC POWER COMPANY'S  
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

**I. INTRODUCTION AND EXECUTIVE SUMMARY**

Southwestern Electric Power Company (SWEPCO or the Company) files these Exceptions to the Proposal for Decision (PFD). The PFD, excluding attachments, is nearly 400 pages long. Understanding that the Company cannot effectively address every aspect of the PFD with which it disagrees, SWEPCO has distilled its exceptions to those issues most important to SWEPCO and its customers and the Commission's continuing regulation of electric utilities in Texas. These exceptions identify instances where the PFD would have the Commission violate the Public Utility Regulatory Act (PURA), ignore the Commission's own rules, endanger SWEPCO's ability to take advantage of accelerated depreciation, circumvent the filed-rate doctrine, and make rulings based on misstatements of fact. Aside from the contested issues of fact and law, the PFD and the number running conducted to implement the PFD's recommendations contain mistakes. Throughout these exceptions, SWEPCO attempts to clearly identify these mistakes so that they may be corrected before an order is issued. SWEPCO files exceptions to the following sections of the PFD:<sup>1</sup>

**Section V.A.1 – Retired Gas-Fired Generating Units**

- SWEPCO prudently retired five gas-fired generation units that served customers for more than 60 years.
- The PFD would have the Commission punish SWEPCO financially for the retirement decision, causing a partial write down of the prudently incurred but undepreciated investment in those plants.
- The PFD has taken too restrictive of a view of the Commission's authority to provide a utility with just and reasonable cost recovery for a retired generating unit with undepreciated value.

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<sup>1</sup> As required by the Exceptions and Reply Memo, these exceptions follow the outline of the PFD (Sep. 20, 2021).

### **Section V.A.2 – Dolet Hills Power Station Retirement**

- The Dolet Hills Power Station (Dolet Hills plant) was providing service to customers during the Test Year and when the rates to be set in this proceeding became effective. The Dolet Hills plant is still providing service to customers today. The Dolet Hills plant will be prudently retired at the end of 2021.
- The PFD would have the Commission violate a clear and meaningful provision of its Cost of Service rule by removing SWEPCO's investment in the Dolet Hills plant from the rate base used to set rates in this proceeding.
- Even if the Commission were to adopt the PFD regarding the rate treatment of the Dolet Hills plant, there are errors in the number running implementation of that recommendation. Those errors are identified below.
- Even if the Commission were to adopt the PFD regarding the rate treatment of the Dolet Hills plant, the PFD has taken too restrictive of a view of the Commission's authority to provide SWEPCO with just and reasonable cost recovery for its investment in the Dolet Hills plant after the plant's retirement.

### **Section V.C. – Net Operating Loss Carryforward (NOLC) ADFIT and Excess ADFIT**

- The PFD erroneously recommends removal of the Company's stand-alone net operating loss carryforward (NOLC) relating to accumulated deferred federal income tax (ADFIT) from the rate base calculation.
- The PFD recommendation effectuates a consolidated tax adjustment, which is prohibited by PURA § 36.060.
- The PFD recommendation, if adopted, would further cause a violation of the Internal Revenue Service's normalization requirements.
- Even if the Commission were inclined to adopt the PFD's recommendation, SWEPCO requests that the Commission protect SWEPCO and its customers from an unintended normalization violation. Below, SWEPCO identifies two alternative ordering paragraphs that will mitigate the risk of an unintended normalization violation.

### **Section V.E - Self-Insurance Reserve and Hurricane Laura Costs**

- The Commission has routinely approved storm reserves for other Texas utilities, finding that such reserves are in the public interest, are a lower cost alternative to purchasing commercial insurance, and result in savings to customers.
- Texas utilities with self-insurance reserves similar to SWEPCO's proposal include AEP Texas, CenterPoint Energy Houston Electric, LLC, Texas-New Mexico Power Company, Entergy Texas, Inc., and Oncor Electric Delivery Company, LLC.

- The PFD's recommendation to reject SWEPCO's self-insurance reserve is based on a faulty standard not contained in the Commission's rule and ignores undisputed expert testimony that self-insurance is more cost-effective than commercial insurance.
- The PFD's proposed storm expense adjustment based on its rejection of a self-insurance reserve is also mistaken. If the PFD's proposed rejection of the self-insurance reserve is adopted by the Commission, \$6.4 million of test year storm costs should be restored given that no party challenged SWEPCO's test year storm costs.
- The Commission should also approve the Company's proposal to charge Hurricane Laura costs against the self-insurance reserve.

#### **Section VI.A – Return on Equity (ROE)**

- The PFD identifies an ROE range of 9% to 9.9%. The PFD then picks the midpoint of this range for SWEPCO – 9.45%.
- The high end of the PFD's range is too low. Even excluding the analyses and recommendations rejected by the PFD, the reasonable range should be 9% to 10.2% with a midpoint of 9.6%.
- The PFD recommended ROE is below the average of awarded ROE's for similarly situated utility companies.

#### **Section VII.A.6 – Allocated Transmission Expenses Related to Retail Behind-the-Meter Generation**

- SWEPCO included Eastman Chemical Company's (Eastman) retail behind-the-meter generation (BTMG) load in the calculation of SWEPCO's Network Load reported to and used by the Southwest Power Pool (SPP) in billing SWEPCO the transmission costs at issue.
- The PFD recommends that Eastman's retail BTMG load be removed when performing the jurisdictional and class allocations of SWEPCO's transmission costs.
- The PFD's recommendation results in the shifting of incremental transmission costs caused by reporting Eastman's retail BTMG load to SPP to jurisdictions and customers that did not cause those costs to be incurred in violation of longstanding principles of cost causation.

### **Section VII.H.1 – Ad Valorem (Property) Taxes**

- The PFD would have the Commission assign an effective property tax rate to Texas customers that is lower than what SWEPCO is actually incurring and lower than the effective tax rate assigned to SWEPCO's customers in Louisiana and Arkansas.
- The PFD's recommendation is based on a misstatement of fact.

### **Section X.B.1.a - General Service (GS) Rate Schedule 50kW Maximum Demand**

- SWEPCO's proposal to eliminate the 50kW maximum demand requirement from the GS tariff offers customers an additional rate option and is no different from previous Commission-approved rate options offered to SWEPCO customers.
- SWEPCO designed the proposed GS tariff to benefit low load factor commercial customers who have been requesting a rate design better suited to their needs.
- The GS tariff proposal was designed with two options, and disallowing the removal of the 50 kW demand cap fundamentally changes the rate design.

### **Section X.B.3 – LLP Rate Schedule and Reactive Power Issues**

- The reactive demand charge is encompassed within and is part of the overall increase.
- It was therefore reasonable for SWEPCO to use the system average increase as the basis for the increase in the reactive demand charge.
- If the reactive demand charge increase sought by SWEPCO is denied, other customers that do not have reactive demand issues will nevertheless be paying for those charges.

## **V. RATE BASE/INVESTED CAPITAL**

### **A. Transmission, Distribution, and Generation Capital Investment**

#### **1. Retired Gas-Fired Generating Units (Exceptions to Finding of Fact (FoF) Nos. 42-43)**

In deciding to retire five gas-fired generating units placed in service between 1949 and 1956, SWEPCO considered the age and condition of the units' equipment, the significant capital investment required for continued operation, and their relatively high cost to generate electricity. In light of those considerations, SWEPCO determined it was in the best interest of its customers to retire the generating units.<sup>2</sup> As recognized by Staff witness Ms. Stark, these units were "retired

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<sup>2</sup> Direct Testimony of Monte McMahon, SWEPCO Ex. 7 at 9:11-10:22.

at the end of their estimated useful lives.”<sup>3</sup> No party challenges the prudence of these retirement decisions.

Despite the fact that these plants served customers for more than 60 years and that SWEPCO prudently decided to retire these units, the PFD would have the Commission punish SWEPCO financially for that retirement decision, causing a partial write down of the prudently incurred but undepreciated investment in these plants. The PFD has taken too restrictive of a view of the Commission’s authority to provide a utility with just and reasonable cost recovery for a retired generating unit with remaining undepreciated value. It is not unusual that some undepreciated value remained at the time of retirement.<sup>4</sup> Indeed, a utility must continue to invest in generating units to ensure that they can provide safe and reliable service until those units are actually retired. The Commission has the authority to allow a carrying cost on this undepreciated value at SWEPCO’s weighted average cost of capital (WACC) or at least at SWEPCO’s average cost of debt, thereby avoiding a punitive write-down of prudently invested capital in generating plants that were prudently retired.

#### **PURA and Commission Precedent**

As recognized in the PFD, SWEPCO accounted for these retirements in accordance with the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USofA), as required under 16 Tex. Admin. Code § 25.72(c).<sup>5</sup> As prescribed by the FERC USofA, SWEPCO recorded the cost of these plants as plant in service at the time the plant was dedicated to public use over 60 years ago. Over time SWEPCO depreciated the assets using Commission approved depreciation rates, which is recorded in accumulated depreciation. Upon retirement, the requirements of the FERC USofA are specific and mandatory:

When a retirement unit is retired from electric plant, with or without replacement, the book cost thereof shall be credited to the electric plant account in which it is included . . . . If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to electric plant shall be charged to the accumulated provision for depreciation applicable to such property.<sup>6</sup>

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<sup>3</sup> Direct Testimony of Ruth Stark, Staff Ex. 3 at 19:19-21.

<sup>4</sup> Rebuttal Testimony of Michael Baird, SWEPCO Ex. 36 at 26:10-13.

<sup>5</sup> Proposal for Decision (PFD) at Finding of Fact (FoF) No. 38; 16 Tex. Admin. Code (TAC) § 25.72(c).

<sup>6</sup> 18 CFR Pt. 101 (FERC USofA) at Electric Plant Instruction 10.B(2) (“Additions and Retirements of Electric Plant”).

By charging accumulated depreciation by the same amount removed from plant in service, the utility's net rate base is held constant and the utility is not punished financially for the prudent retirement decision. But the PFD recommends the Commission remove the undepreciated value of these plants at the time of their retirement from accumulated depreciation, thereby reducing SWEPCO's net rate base on which it should receive a reasonable return for shareholders who provided the necessary equity capital. The PFD's sole basis for this recommendation is the Commission's ratemaking treatment ordered in Docket No. 46449 for SWEPCO's retired Welsh Unit 2.

Welsh Unit 2 was not the first utility generating unit to be retired with some amount of undepreciated value. Yet, Docket No. 46449 was the first time that the Commission departed from the prescribed accounting treatment and removed the undepreciated value of a retired generating unit from accumulated depreciation, thereby reducing net rate base. Thus, the treatment of Welsh Unit 2 in that docket was unique.<sup>7</sup> Indeed, the circumstances with respect to Welsh Unit 2's retirement were unique even within the context of Docket No. 46449 itself because Lieberman Unit 1, a gas fired unit, had been retired in 2015,<sup>8</sup> before the conclusion of the test year addressed in Docket No. 46449. Yet, the Commission made no adjustment in Docket No. 46449 to accumulated depreciation and net rate base associated with Lieberman Unit 1. Instead, the Commission properly allowed the ratemaking for Lieberman Unit 1 to follow the requirements of the FERC USofA.

The PFD does not dispute the uniqueness of the ratemaking treatment afforded Welsh Unit 2. Nonetheless, the ALJs appear to conclude they are constrained by that decision. They wrote, "[w]hether fairly characterized as consistent with prior precedent or a departure from it, the ALJs will follow this most recent authoritative pronouncement from the Commission, unless and until the Commission or the Legislature instructs otherwise."<sup>9</sup> The Commission is not so restricted by PURA or prior precedent and should declare as much to avoid confusion and unjust results going forward.

In establishing a utility's rates, PURA § 36.051 mandates the Commission "permit the

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<sup>7</sup> SWEPCO Ex. 36 at 26:10-27:5 ("SWEPCO has retired various gas units in the past and the Commission has never singled out and addressed retired gas plants this way.").

<sup>8</sup> SWEPCO Ex. 7 at 6:17-21.

<sup>9</sup> PFD at 25 (footnote omitted).

utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of the utility's reasonable and necessary operating expenses." This directive is a positive statement of the Commission's obligation to provide a reasonable return on invested capital "used and useful" in providing service. This directive does not forbid the Commission from recognizing that there is a cost of financing investment in a generation asset that is prudently retired with undepreciated value. In other words, the statute is silent regarding a return afforded to an investment in a generation facility that the Commission views as no longer used after retirement, other than requiring the Commission permit recovery of the "utility's reasonable and necessary operating expenses."

Consistent with this reading of PURA § 36.051, the Commission has recognized its statutory authority to "balance equities" when setting cost recovery for assets that may no longer be considered used or useful. In addressing Excess Cost over Market (ECOM), also known as stranded costs, ahead of the introduction of unbundled, competitive generation in Texas, the Commission recognized its authority to allow recovery of the cost to finance such assets, noting:

In its mandated role as a substitute for competition, the Commission pursuant to PURA § 2.203 [predecessor to § 36.051] must in each rate proceeding set overall revenues at a level to provide a reasonable opportunity to earn a reasonable return on invested capital used and useful in rendering service. ECOM is inherently economically unuseful, or at a minimum less useful, in rendering service. Under the "used" standard applied in past cases, the Commission exercised its authority to balance equities by allowing recovery of capital costs while eliminating or reducing the return on those assets that have been found prudent, but that are not used to provide service. The same rationale may be consistently applied when assets are unuseful.<sup>10</sup>

The Commission did not view itself constrained by an "either/or" choice of allowing a traditional regulated return or no cost of financing at all. Instead, the Commission allowed a traditional return on non-ECOM invested capital, while still recognizing that there are costs associated with financing ECOM:

For the non-ECOM portion of invested capital, the rates include amounts for both depreciation and return on investment, calculated in accordance with traditional regulatory principles. For the ECOM portion of invested capital, the rates include amounts for both depreciation and return on investment; the depreciation is more rapid than is the case under traditional regulatory principles while the rate of return

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<sup>10</sup> *Application of Central Power and Light Company for Authority to Change Rates*, Docket No. 14965, Second Order on Rehearing at 2 (Word doc) (emphasis omitted) (Oct. 16, 1997).

is lower, but reasonable.<sup>11</sup>

The Hawaii Public Utilities Commission has addressed circumstances similar to those faced by SWEPCO, recognizing that a carrying cost is an appropriate cost of service regarding the undepreciated value of retired property:

We agree with GASCO that allowing a carrying charge on the unamortized balance of the value of retired or abandoned property is not equivalent to providing a rate of return on a rate base that is nonexistent as argued by the CA. Once it is determined that the undepreciated value of retired or abandoned property should be allowed to be amortized over a reasonable period, it is but a short step to allowing a carrying charge, on the unamortized balance, that relates to the cost of debt issued for the construction of retired or abandoned property, so long as the retirement or abandonment before the end of the property's useful life has been amply justified. The recovery allowed is recovery of all of the unrecovered cost of the property. We, thus, allow a carrying charge of 8.46 per cent per annum.<sup>12</sup>

The Oklahoma Corporation Commission took the same path for a generating unit retired by SWEPCO's sister AEP operating company, Public Service Company of Oklahoma (PSO). Despite the fact that the Oklahoma commission embraces the "used and useful" ratemaking concept, that Commission allowed a carrying charge on the undepreciated value of PSO's retired Northeastern Unit 4 (NE 4): "In balancing the interests of ratepayers and shareholders, THE COMMISSION FINDS it appropriate under the circumstances presented here to authorize a return of the investment associated with NE 4 and recovery of the carrying cost on the remaining investment at the cost of debt allowed in this proceeding."<sup>13</sup>

It is undisputed that: (1) SWEPCO's investment in these now-retired gas plants was reasonable and necessary to provide service to customers; (2) SWEPCO incurred a cost to finance that investment; and (3) the retired gas units were prudently retired after serving the public for more than 60 years. Given these undisputed facts, it is appropriate for the Commission to recognize that SWEPCO's full WACC has financed these assets. At the least, the Commission should afford SWEPCO recovery of its average cost of debt on the undepreciated value of these

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<sup>11</sup> Docket No. 14965, Second Order on Rehearing at 3 (Word doc).

<sup>12</sup> *Re Gasco, Inc.*, 132 P.U.R.4th 352 (Hawaii P.U.C. Apr. 3, 1992).

<sup>13</sup> *Application of Public Service Company of Oklahoma, an Oklahoma Corporation, for an Adjustment in its Rates and Charges and the Electric Service Rules, Regulations and Conditions of Service for Electric Service in the State of Oklahoma*, Oklahoma Corporation Commission Cause No. PUD 201700151, Final Order (Order No. 672864) at 3 (Jan. 31, 2018).

retired plants, thereby avoiding a punitive write down of a portion of that prudent, reasonable, and necessary investment.

SWEPCO requests that the Commission replace Findings of Fact Nos. 41-42 with the following findings:

- It is undisputed that SWEPCO's investment in these gas plants that are now retired was reasonable and necessary to provide service to customers and that the utility incurred a cost to finance that investment.
- Given that these retired gas units were prudently retired after serving the public for more than 60 years, it is appropriate for the Commission to recognize that SWEPCO's full weighted average cost of capital has financed these assets.
- [In the alternative to the above] The Commission affords SWEPCO recovery of its average cost of debt on the undepreciated value of these retired plants, thereby avoiding a write down of a portion of that prudent, reasonable, and necessary investment.

**2. Dolet Hills Power Station Retirement (Exceptions to FoF Nos. 57-64)**

Contrary to the requirements of the Commission's Cost of Service rule, the PFD recommends that SWEPCO's undepreciated investment in the Dolet Hills plant be removed from the rate base used to set base rates in this proceeding. This recommendation will produce rates that are not just and reasonable and will not provide SWEPCO an opportunity to earn a reasonable return on its capital invested in the service of customers, as is required by law. SWEPCO's exceptions to this recommendation are contained in the section immediately below, Section V.A.2.a.

Nonetheless, if the Commission were to adopt the PFD's recommendation in this respect, the number running schedules filed on August 30, 2021, fail to accurately implement the PFD's recommendation for removing Dolet Hills plant investment from the rate base used to determine base rates and placing it into a "Dolet Hills Rate Recovery Rider." SWEPCO's alternative exceptions related to these errors and the PFD's failure to provide a reasonable carrying cost on SWEPCO's undepreciated investment in the Dolet Hills plant are contained in Section V.A.2.b.

SWEPCO asks the Commission to reject the PFD's recommendation to remove SWEPCO's undepreciated investment in the Dolet Hills plant from rate base. However, if the Commission disagrees, errors in the Dolet Hills Rate Recovery Rider and base rates shown in the number running schedules need to be corrected.

**a. Exceptions addressing PFD recommendation regarding Dolet Hills plant**

The Commission's Cost of Service rule is clear and unambiguous in its application to the Dolet Hills plant. The Dolet Hills plant was providing service to customers when the rates to be set in this proceeding became effective. As such, the Cost of Service rule includes SWEPCO's investment in the Dolet Hills plant as a required element of the historical Test Year rate base the Commission uses to set rates. The PFD alleges no ambiguity in the Commission's rule or its application to the Dolet Hills plant. Instead, the PFD alleges good cause to deviate from the rule. The PFD's alleged "good cause exception" will simply eliminate a clear and meaningful requirement in the Cost of Service rule. It is the job of the Commission, not an ALJ, to adopt and change Commission rules. The ALJs' willingness to disregard an unambiguous Commission rule is confounding given their stated reluctance to be seen as departing from Commission precedent.<sup>14</sup> The only commonality in the ALJs' simultaneous alleged adherence to precedence and deviation from the Cost of Service rule is that in both instances it impairs SWEPCO's ability to earn a reasonable return on its capital invested to serve customers.

**Background**

The Dolet Hills plant is located southeast of Mansfield, Louisiana and is a 650 net MW lignite fueled generating plant. Lignite for the Dolet Hills plant is mined from the adjacent Dolet Hills and the Oxbow lignite reserves (collectively referred to as the Mines). The Dolet Hills plant is owned by Cleco Power, LLC (CLECO), SWEPCO, Northeast Texas Electric Cooperative, Inc., and the Oklahoma Municipal Power Authority. CLECO operates and manages the Dolet Hills plant pursuant to the Dolet Hills Power Station Ownership, Construction and Operating Agreement.<sup>15</sup>

The Dolet Hills plant began providing service to customers 35 years ago, in 1986. However, SWEPCO filed no request to adjust its base rates in Texas until many years later. The Commission did not place SWEPCO's investment in the Dolet Hills plant or the O&M expenses to operate the plant into rates until 2010, in Docket No. 37364. In other words, the Dolet Hills

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<sup>14</sup> PFD at 25 ("[w]hether fairly characterized as consistent with prior precedent or a departure from it, the ALJs will follow this most recent authoritative pronouncement from the Commission, unless and until the Commission or the Legislature instructs otherwise.")

<sup>15</sup> Direct Testimony of Thomas P. Brice, SWEPCO Ex. 4 at 5:17-6:4.

plant provided service to Texas customers for 25 years before SWEPCO's investment in the plant and the non-fuel expenses associated with it were placed in Texas rates.<sup>16</sup>

Despite diligent efforts to reduce costs at the Mines, SWEPCO and CLECO determined that mining activities should cease because of increased mining costs and changing market circumstances and that the Dolet Hills plant will be retired at the end of 2021. SWEPCO studied the expected total SWEPCO system cost to serve customers under the scenario where the Dolet Hills plant continues to serve customers through 2026 and the scenario where the Dolet Hills plant is retired by December 31, 2021. That study demonstrates the expected least cost path for SWEPCO and its customers lies in retirement of the Dolet Hills plant.<sup>17</sup> At Finding of Fact No. 50, the PFD correctly finds, "[n]o party contested the prudence of SWEPCO's decision to retire Dolet Hills at the end of 2021. The decision was prudent."

During 2021, the Dolet Hills plant provided service during the peak summer months, when the plant typically is most needed by SWEPCO's customers. The plant continues to remain available if called upon by SWEPCO's and CLECO's respective Regional Transmission Organizations (RTOs) for reliability reasons.<sup>18</sup>

### **The Cost of Service Rule**

Pursuant to the Commission's Cost of Service rule, rates are to be based upon a utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes.<sup>19</sup> The utility's invested capital used to provide service to customers (referred to as "rate base" in the Cost of Service rule) is measured at the end of the test year. The Test Year applicable to this proceeding ended nearly 18 months ago, on March 31, 2020. The Dolet Hills plant was providing service to customers at the end of the Test Year and is today. As an investment essential to providing service to customers during the Test Year, SWEPCO's investment in the Dolet Hills plant is an essential element of the Test Year rate base used to set rates under the Cost of Service rule.

The Cost of Service rule does allow post-test year adjustments to test year rate base, but

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<sup>16</sup> Rebuttal Testimony of Thomas P. Brice, SWEPCO Ex. 33 at 5:20-6:7.

<sup>17</sup> SWEPCO Ex. 33 at 6:8-15.

<sup>18</sup> SWEPCO Ex. 33 at 6:20-7:1. SWEPCO operates in the Southwest Power Pool (SPP).

<sup>19</sup> 16 TAC § 25.231(a).

only when very specific criteria are met. 16 TAC § 25.231(c)(2)(F) sets out the requirements for a post-test year adjustments to test year rate base. While the rule provides an additional hurdle for a post-test year rate base addition (*i.e.*, addition comprises at least 10% of the utility's requested rate base), the rule contains the same temporal component for both post-test year additions and post-test year reductions to rate base: the plant in question must be in service (additions) or removed from service (decreases) *prior* to the Rate Year.<sup>20</sup>

The term Rate Year is defined in the Commission's rules as the 12-month period beginning with the first date that rates become effective.<sup>21</sup> By law, rates set in this proceeding are effective for energy consumption on and after the 155th day after the date SWEPCO filed this proceeding.<sup>22</sup> In this case, the rates to be set in this proceeding became effective more than six months ago on March 18, 2021.<sup>23</sup> The Dolet Hills plant was providing service to customers during the Test Year and prior to the Rate Year and will continue to provide service through the end of 2021.<sup>24</sup> Because the Dolet Hills plant was still providing service prior to the Rate Year (when the rates to be set in this proceeding became effective), by the terms of the Cost of Service rule, that plant must remain in SWEPCO's rate base for the purpose of setting rates in this proceeding. The PFD denies none of these facts.

The ALJs admit that the timing restriction placed on post-test year adjustments to rate base "is no mere empty formalism."<sup>25</sup> Indeed, the PFD observes that the timing restriction serves important and beneficial regulatory principles in the context of ratemaking and that "the Commission must necessarily draw *some* temporal cut-off line for post-test-year rate-base adjustments, and it has done so in Section 25.231(c)(2)(F)(iii)(II) – the start of the rate year."<sup>26</sup> There is no debate in this proceeding regarding the requirements of the Cost of Service rule.

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<sup>20</sup> 16 TAC § 25.231(c)(2)(F)(i)(III) and (iii)(II).

<sup>21</sup> 16 TAC § 25.5(101).

<sup>22</sup> Public Utility Regulatory Act (PURA), Tex. Util. Code Ann. § 36.211(b).

<sup>23</sup> *See* SOAH Order No. 2 at 2 ("Relate-Back date under PURA § 36.211 – March 18, 2021") (Nov. 23, 2020).

<sup>24</sup> SWEPCO has now provided notice to the SPP that the Dolet Hills plant will retire at the conclusion of December 31, 2021.

<sup>25</sup> PFD at 50.

<sup>26</sup> PFD at 50 (emphasis in original).

### **Alleged Good Cause**

In an attempt to justify circumventing an important and unambiguous provision of the Cost of Service rule, the PFD describes a false “conflict” between the Cost of Service rule and the cost recovery afforded by the Commission in Docket No. 46449 for SWEPCO’s long-retired Welsh Unit 2 generation unit. But, in reality, no such conflict exists. SWEPCO’s Welsh Unit 2 had been retired before the end of the Docket No. 46449 test year<sup>27</sup> and more than a year before the Docket No. 46449 rates became effective. The Cost of Service rule on post-test year adjustments to rate base, central to this case, was not implicated or even discussed in Docket No. 46449.

Because Welsh Unit 2 retired before the end of the test year in that case,<sup>28</sup> SWEPCO proactively removed the remaining undepreciated value of Welsh Unit 2 from plant in service before SWEPCO filed Docket No. 46449. The ratemaking question addressed in Docket No. 46449 was whether that remaining undepreciated value of Welsh Unit 2 removed from plant in service should be debited to accumulated depreciation, as required by the FERC Uniform System of Accounts,<sup>29</sup> thereby holding net rate base constant, or be moved into a regulatory asset. The Commission chose the latter<sup>30</sup> and afforded no return on that regulatory asset. These circumstances do not exist in this case. The Dolet Hills plant:

- was not retired before the end of the Test Year,
- was not retired before the beginning of the Rate Year, and
- still provides service today.

As such, SWEPCO’s investment in the Dolet Hills plant is clearly part of the rate base used to provide service to customers during the historical Test Year.

The PFD claims that following the Cost of Service rule temporal requirements for adjustments to test year rate base would invite “manipulation in the future by utilities anticipating retirements of generation units.”<sup>31</sup> The ALJs may not eliminate an explicit and meaningful provision of the Cost of Service rule on the basis that “manipulation” may occur in the future. In

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<sup>27</sup> In Docket No. 46449, SWEPCO employed the 12-month period ending June 30, 2016 as its test year.

<sup>28</sup> *See Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at FoF No. 65 (Mar. 19, 2018).

<sup>29</sup> Docket No. 46449, Order on Rehearing at FoF No. 67.

<sup>30</sup> Docket No. 46449, Order on Rehearing at FoF No. 71.

<sup>31</sup> PFD at 51.

this proceeding there is no evidence of any manipulation. SWEPCO filed this rate proceeding because its current rates are not providing SWEPCO with an opportunity to earn a reasonable return on its capital invested to provide service over and above its reasonable and necessary expenses to provide that service. The PFD describes this fact as a “perceived” inability to earn a reasonable return in excess of its operating costs.<sup>32</sup> The rates recommended by the PFD prove that this inability is actual and not merely “perceived.” Even after the unfavorable rate treatment afforded SWEPCO’s investment in the Dolet Hills plant and other negative and erroneous recommendations contained in the PFD, the PFD still recommends that SWEPCO’s Texas jurisdictional rates be increased by more than \$41 million per year.<sup>33</sup> This inability to earn a reasonable return on SWEPCO’s capital invested in the service of customers was the sole driver for this proceeding.

### **Just and Reasonable Rates**

The stated purpose of PURA is to establish a regulatory system for public utilities that establishes rates “that are just and reasonable to the consumers and to the electric utilities.”<sup>34</sup> Removing SWEPCO’s investment in the Dolet Hills plant from rate base at the time of its retirement, *21 months after the close of the historical Test Year*, does not result in just and reasonable rates. The PFD proposes to remove one investment – SWEPCO’s investment in the Dolet Hills plant – from rate base 21 months after the close of the historical Test Year without recognizing any of the additions to rate base that have been and will be made over that same 21 months. The PFD makes light of this fact and exhibits a lack of understanding of the magnitude of the investment already made by SWEPCO in the service of customers since the close of the March 31, 2020 Test Year. The PFD observes a Test Year undepreciated value of \$122.8 million for the Dolet Hills plant and then states, “[a]lthough SWEPCO insists there is a possibility of offsetting new capital investment, it cites a figure (\$88 million) that would be dwarfed by the effect of the Dolet Hills retirement.”<sup>35</sup> As an initial matter, offsetting capital investment is not a “possibility,” it is a fact. Further, the PFD fails to recognize that the actual increase in net plant of

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<sup>32</sup> PFD at 51.

<sup>33</sup> See PFD at 6. SWEPCO’s requested Texas jurisdictional rate increase (rebuttal case) was \$85.2 million. The PFD states that its recommendation is a reduction of \$43.8 million.

<sup>34</sup> PURA § 31.001(a). See also PURA § 11.002(a).

<sup>35</sup> PFD at 52.

\$88 million is only through March 31 of this year. That amount will continue to grow over the intervening nine months until the Dolet Hills plant retires at the end of this year, clearly approaching the undepreciated value of the Dolet Hills plant. In fact, the \$88 million of net plant additions for the twelve months ending March 31, 2021 equates to \$7.33 million per month.<sup>36</sup> Based on this pace, SWEPCO will add approximately \$154 million in net plant<sup>37</sup> by the time the Dolet Hills plant is retired, which more than offsets the \$122.8 million net investment in the Dolet Hills plant. The fact is that rate base tends to increase over time, not decrease. Specifically, since the end of the Test Year (March 31, 2020) through March 31, 2021, SWEPCO's gross plant has increased by \$244 million, while its net plant has increased by \$88 million.<sup>38</sup> These increases in plant are reflective of increased investments at a point in time *nine months before the Dolet Hills plant will be retired* and SWEPCO's gross and net plant will continue to increase through the time the Dolet Hills plant is retired. Penalizing SWEPCO by removing costs associated with the Dolet Hills plant from rates after its retirement without accounting for additional investment placed into service through that same date:

- is arbitrary and one-sided, in violation of the Cost of Service rule,
- is arbitrary and one-sided, in violation of the matching principle, and
- will not result in just and reasonable rates or afford SWEPCO an opportunity to earn a reasonable return on its capital invested to serve customers, as is required by law.<sup>39</sup>

The ALJs allege good cause to make an exception to 16 TAC § 25.231(c)(2)(F)(iii)(II).<sup>40</sup> In truth, if upheld, the PFD would simply eliminate this provision – that a post-test year adjustment for rate base decreases will be allowed only when that plant has been removed from service prior to the rate year. The PFD's recommendation would (1) destroy the symmetry the Commission built into the Cost of Service rule for post-test year adjustments to rate base and (2) change that rule to allow a post-test year adjustment for rate base decreases when a plant is expected to retire sometime while the rates to be set will be in effect. If the Commission had wanted that to be the

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<sup>36</sup> \$88 million/12.

<sup>37</sup> \$7.33 million\*21.

<sup>38</sup> SWEPCO Ex. 36 at 17:10-12.

<sup>39</sup> SWEPCO Ex. 33 at 10:7-20.

<sup>40</sup> PFD at 52.

rule, it would have expressed that in the rule. The Commission did not. Instead, the Commission approved a rule that contains a temporal symmetry for post-test year adjustments to test year rate base – the plant in question must be in service (additions) or removed from service (decreases) prior to the rate year.<sup>41</sup>

### **Mitigation of Rate Impact of Including Dolet Hills in Rate Base**

Generally accepted accounting principles (GAAP) and standard regulatory practice call for the remaining undepreciated value of Dolet Hills to be depreciated through 2021. In fact, this is required by the Commission’s Cost of Service rule: “Depreciation shall be computed on a straight line basis or by such other method approved under subsection (b)(1)(B) of this section over the expected useful life of the item or facility.”<sup>42</sup> SWEPCO realizes that depreciating the Dolet Hills plant over its end of 2021 service life for ratemaking purposes would have a significant impact on SWEPCO’s base rates that are to be set in this proceeding.<sup>43</sup> For that reason, SWEPCO offers two mitigation measures.

First, SWEPCO proposes to offset the undepreciated value of the Dolet Hills plant (an asset) with Excess Accumulated Deferred Federal Income Tax (Excess ADFIT) (a liability). When the United States Congress reduced the federal corporate income tax rate to 21% in 2018, an excess of ADFIT was created for SWEPCO and other utilities. In SWEPCO’s previous general base rate case, Docket No. 46449, the Commission ordered that excess deferred taxes resulting from the reduction in the federal income tax rate be addressed in SWEPCO’s next base-rate case.<sup>44</sup> SWEPCO proposes that the balance of the unprotected Excess ADFIT and the refund provision associated with the protected Excess ADFIT be used to offset the undepreciated value of Dolet Hills.<sup>45</sup>

SWEPCO’s Excess ADFIT offset proposal is consistent with both PURA and the Cost of Service rule. Under the Cost of Service rule, ADFIT is expressly recognized as a deduction (offset)

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<sup>41</sup> 16 TAC § 25.231(c)(2)(F)(i)(III) and (iii)(II).

<sup>42</sup> 16 TAC § 25.231(c)(2)(A)(ii).

<sup>43</sup> SWEPCO Ex. 4 at 7:3-11.

<sup>44</sup> Docket No. 46449, Order on Rehearing at Ordering Paragraph No. 10.

<sup>45</sup> SWEPCO Ex. 4 at 7:12-8:1.

to invested capital (rate base).<sup>46</sup> While ADFIT has always been an offset to invested capital in the Cost of Service rule, in this case SWEPCO proposes to use its Excess ADFIT to offset a specific item of invested capital – SWEPCO’s undepreciated capital invested in the Dolet Hills plant. SWEPCO makes this proposal to mitigate the rate impact produced by the change in the service life of the Dolet Hills plant that is required by the Cost of Service rule and consistent with GAAP and the FERC USofA. From a layman’s perspective, SWEPCO’s proposal to offset the recovery of its Dolet Hills investment from customers with the Excess ADFIT simply balances an investment prudently incurred to provide service to customers with the Excess ADFIT legitimately returnable to customers.<sup>47</sup>

The Commission has allowed a similar Excess ADFIT offset in the context of a storm restoration regulatory asset, thus reducing the amount of the restoration regulatory asset recoverable from customers. The signatories to the settlement in Docket No. 48577 agreed to offset AEP Texas’ catastrophe reserve regulatory asset with unprotected Excess ADFIT. While the Commission’s Order in Docket No. 48577 does not constitute binding precedent, the Commission did expressly find that “[t]he Settlement Agreement’s treatment of ADFIT is appropriate.”<sup>48</sup> While the asset in Docket No. 48577 might be different, this finding is an indication that the Commission has the authority to use Excess ADFIT as a means to reduce the cost of an asset includable in customer rates and that such an offset is consistent with PURA.<sup>49</sup>

The only thing that will be achieved by forgoing the excess ADFIT offset to the undepreciated investment in Dolet Hills will be the shifting of costs to future customers. Spreading Dolet Hills’ costs will create intergenerational inequities, by spreading costs to future customers for decades, well after the Dolet Hills plant will be retired. On the other hand, the excess ADFIT offset serves the interest of intergenerational equities by using excess ADFIT owed to existing customers to offset the undepreciated value of the Dolet Hills plant that has provided service to those same customers.

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<sup>46</sup> 16 TAC § 25.231(c)(2)(C)(i). While the reduction in the corporate tax converted a portion of ADFIT into Excess ADFIT, until refunded, that Excess ADFIT is a regulatory liability that would offset rate base.

<sup>47</sup> SWEPCO Ex. 33 at 16:3-12.

<sup>48</sup> *Application of AEP Texas, Inc. for Determination of System Restoration Costs*, Docket No. 48577, Order at FoF No. 54 (Feb. 28, 2019).

<sup>49</sup> SWEPCO Ex. 36 at 6:21-7:7.

The amount of unprotected Excess ADFIT and the protected Excess ADFIT refund provision will not completely offset the Dolet Hills plant's undepreciated value.<sup>50</sup> As a second mitigation measure, after the Excess ADFIT offset, SWEPCO offers to expense the remaining value of SWEPCO's investment in the Dolet Hills plant over four years, the anticipated period between rate cases.<sup>51</sup> Absent this additional mitigation proposal, the remaining net book value after the Excess ADFIT offset would be depreciated over the service life of the Dolet Hills plant through the end of 2021.

SWEPCO requests that the Commission replace Findings of Fact Nos. 57 through 64 with the following:

- Because the Dolet Hills plant was still in service prior to the Rate Year, consistent with the terms of the Cost of Service rule, it properly remains in SWEPCO's historical rate base for the purpose of setting rates in this proceeding.
- To remove costs associated with the Dolet Hills plant from rates after its retirement and well after the rates in this proceeding became effective without accounting for additional investment placed into service and other changes to SWEPCO's costs of service through that same date is asymmetrical and will not result in just and reasonable rates.
- Realizing that depreciating the Dolet Hills plant over its 2021 service life for ratemaking purposes would have a significant impact on SWEPCO's base rates, SWEPCO proposes to offset the undepreciated value of the Dolet Hills plant with excess Accumulated Deferred Federal Income Tax (ADFIT).
- SWEPCO's proposal to offset the recovery of its Dolet Hills investment from customers with the excess ADFIT balances an investment prudently incurred to provide service to customers with the excess ADFIT legitimately returnable to customers is reasonable.
- SWEPCO's ADFIT offset proposal provides benefits to existing and future customers and better achieves intergenerational equities.
- The amount of unprotected excess ADFIT and the protected excess ADFIT refund provision will not completely offset the Dolet Hills plant's undepreciated value. After the Excess ADFIT offset, SWEPCO proposes to expense the remaining value

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<sup>50</sup> SWEPCO Ex. 4 at 7:13-8:7.

<sup>51</sup> Direct Testimony of Michael Baird, SWEPCO Ex. 6 at 49:15-18.

of SWEPCO's investment in the Dolet Hills plant over four years. This proposal is reasonable.

**b. Errors in the Dolet Hills Rider (Alternative Exceptions to Number Run Workpaper and FoF Nos. 60 and 62)**

Notwithstanding the above, if the Commission still determines that the undepreciated value of the Dolet Hills plant should be removed from rate base and placed in a rider, SWEPCO asks that the Commission correct errors in the structure of that rider and base rates. Specifically, should the Commission adopt the recommended "Dolet Hills Rate Recovery Rider" (Dolet Hills rider), SWEPCO excepts to the calculations included in the excel workbook number run workpaper "7\_51415 PFD Dolet Hills Rider and COS Adjustments" posted as Item No. 663 on the Commission's interchange for this docket. The errors identified below encompass errors that both increase and decrease the amounts to be recovered by the Dolet Hills rider and the amount of base rates.

**ADFIT and Materials and Supplies were left out of the rider**

The ALJs determined that it is appropriate to remove all cost recovery for Dolet Hills from base rates and address cost recovery in the Dolet Hills rider. The net book value of Dolet Hills includes Accumulated Deferred Federal Income Taxes (ADFIT) and Materials and Supplies (M&S) that were not removed from rate base on Attachment A to the PFD,<sup>52</sup> nor were they included in the Dolet Hills rider.<sup>53</sup> As such, these costs should be removed from rate base and included in the net book value of Dolet Hills for the Dolet Hills rider. ADFIT and M&S, just like plant are a component of the Dolet Hills net asset and its net book value and should be accounted for the same way as plant in the Dolet Hills rider. The amount to be removed from rate base for ADFIT would be 21% of the Dolet Hills asset and will increase the net book value of Dolet Hills included in the Dolet Hills Rider. Based on the evidentiary record in this case, the amount of Dolet Hills ADFIT to be included as a reduction to Dolet Hills net book value in the rider is \$25,786,933.<sup>54</sup> Based on the evidentiary record in this case, the amount of M&S to be added to

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<sup>52</sup> Adjustments to rate base are shown on Attachment A, PFD Schedule III, Invested Capital, Page 1 of 1.

<sup>53</sup> See Number Running Workpapers at 7\_51415 PFD Dolet Hills Rider and COS Adjustments at tab Dolet Hills Recovery Riders (Aug. 30, 2021).

<sup>54</sup> SWEPCO Ex. 36 at Exhibit MAB-2R (\$122,794,917 \* 21%).

the Dolet Hills net book value is \$3,733,171 (Total Company).<sup>55</sup> The Findings of Fact should be clarified by noting that the Dolet Hills net book value includes all Dolet Hills related items at the time of retirement including applicable ADFIT on the new regulatory asset and any unused M&S.

**Demolition costs were left out of the rider**

The ALJs correctly find “SWEPCO’s calculation and use of estimated demolition costs for Dolet Hills is reasonable.”<sup>56</sup> SWEPCO used the demolition costs to increase the net book value of the Dolet Hills plant, which provides recovery of these future costs.<sup>57</sup> In addition, the ALJs follow the basic rate-rider model proposed by OPUC witness Ms. Cannady. As detailed on Schedule CTC-12 of her testimony, Ms. Cannady appropriately added \$10,740,383 of estimated demolition costs<sup>58</sup> to be recovered at retirement to her net book value. However, the excel workbook number run workpaper “7\_51415 PFD Dolet Hills Rider and COS Adjustments” posted as Item No. 663 on the Commission’s interchange does not include these appropriately recoverable costs as noted in proposed Findings of Fact No. 65. The amount to be added to the Dolet Hills net book value is \$10,740,383. The final net book value to be included in the Dolet Hills rider is \$137,268,471.<sup>59</sup> This will increase the total company expenses to be recovered in 2021 from \$24,736,424 to \$24,605,172<sup>60</sup> and the total company annual expenses to be recovered starting in 2022 from \$5,477,277 to \$5,428,884.<sup>61</sup>

**Amortization of Oxbow investment should be removed from the Dolet Hills rider**

SWEPCO excepts to the inclusion of the amortization of SWEPCO’s Oxbow investment in the Dolet Hills rider beginning in 2022 because the amortization of the Oxbow investment is not recovered as part of the Dolet Hills plant net book value, depreciation, or O&M. Instead, the amortization of the Oxbow investment is recovered as fuel expense and will be recovered through

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<sup>55</sup> Dolet Hills Plant / Total Production Plant (Schedule D-4) \* Production M&S (JOA WP – SWEPCO TX COS\_Class TY 3-2020 Rebuttal Excel Spreadsheet) – (\$339,874,755 / \$4,693,518,580 \* \$51,553,430) = \$3,733,171.

<sup>56</sup> PFD at FoF No. 65.

<sup>57</sup> SWEPCO Ex. 6 at Exhibit MAB-4; SWEPCO Ex. 36 at Exhibit MAB-2R.

<sup>58</sup> OPUC Ex. 20, Schedule CTC-12, shown on line “Demolition Costs to be Recovered at Retirement.”

<sup>59</sup>  $\$122,794,917 + \$3,733,171 + \$10,740,383 = \$137,268,471$ .

<sup>60</sup> Substitute the above amounts into the number run spreadsheet by adjusting net book value to include ADFIT, M&S, Demolition and Oxbow as applicable. Return net book value amount is \$128,057,719 (\$137,268,471 NBV - \$25,786,933 ADFIT) whereas recovery amount is the NBV \$137,268,471.

<sup>61</sup> Substitute the above amounts into the number run spreadsheet by adjusting net book value to include M&S and Demolition or \$137,268,471 and excluding the Oxbow investment.

SWEPCO's fuel factor and reconciled as part of eligible fuel expense.<sup>62</sup> Inclusion in both eligible fuel and in the Dolet Hills rider would result in a double recovery for SWEPCO, thus the Commission should delete proposed Findings of Fact No. 62.

To be clear, the return on SWEPCO's Oxbow investment is properly included in the Dolet Hills rider through 2021. This return is proper and is identified on the Dolet Hills rider workpaper.<sup>63</sup> However, the amortization of that investment beginning in 2022, also shown on the Dolet Hills rider workpaper,<sup>64</sup> is recovered as a fuel cost and should be removed from the rider calculation.

**The Dolet Hills rider tariff will need a true-up mechanism**

Since Ms. Cannady's basic rate-rider model recommendation does not contain a proposed tariff, SWEPCO believes that the Commission should clarify how an update from the estimated amounts included in the Dolet Hills rider to the final actual amounts will occur. The net book value of Dolet Hills will not be known until after it is retired. At that time, the level of net plant in service will be final and the amount of any unused M&S can be determined. In addition, demolition of the plant will occur after the plant is closed. As such, the Dolet Hills rider should include an update provision, so that once the final amounts are known, the Dolet Hills rider rate can be modified, either up or down, to recognize the final amounts as deemed prudent by the Commission. SWEPCO will include such a provision in the Dolet Hills rider when SWEPCO files compliance tariffs at the conclusion of this case.

**Carrying Cost on the Dolet Hills rider beginning in 2022**

Despite the fact that the Dolet Hills plant has served customers for more than 35 years; despite the fact that the plant served customers for 25 years before SWEPCO's investment in the plant was placed into rates; and despite that facts that SWEPCO's investment in the plant and the decision to retire that plant were prudent; the PFD would have the Commission punish SWEPCO financially for that retirement decision, causing a partial write down of the prudently incurred but undepreciated investment in this plant. The PFD has taken too restrictive of a view of the

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<sup>62</sup> SWEPCO Ex. 36 at 22: 4-9.

<sup>63</sup> Number Running Workpapers at 7\_51415 PFD Dolet Hills Rider and COS Adjustments at tab Dolet Hills Recovery Riders, Section A.3 - Return and FIT to be recovered Oxbow and Dolet Hills fuel.

<sup>64</sup> Number Running Workpapers at 7\_51415 PFD Dolet Hills Rider and COS Adjustments at tab Dolet Hills Recovery Riders, Section B – Oxbow Mine Investment.

Commission's authority to provide a utility with just and reasonable cost recovery for a retired generating unit with remaining undepreciated value. The Commission has the authority to allow a carrying cost on this undepreciated value at SWEPCO's weighted average cost of capital or, at least, at SWEPCO's average cost of debt, thereby avoiding a punitive write-down of prudently invested capital.

The PFD would have the Commission deny any carrying costs for the undepreciated value of the Dolet Hills plant at the time of its retirement. The PFD's sole basis for this recommendation is the Commission's ratemaking treatment ordered in Docket No. 46449 for SWEPCO's retired Welsh Unit 2. As discussed above in the section addressing SWEPCO's retired gas generation units, the ratemaking treatment of Welsh Unit 2 in that docket was unique.<sup>65</sup> Nonetheless, it appears the ALJs felt constrained by that decision: "Whether fairly characterized as consistent with prior precedent or a departure from it, the ALJs will follow this most recent authoritative pronouncement from the Commission, unless and until the Commission or the Legislature instructs otherwise."<sup>66</sup> The Commission is not so restricted by PURA or precedent.

The analysis applicable to a just and reasonable carrying cost on the undepreciated value of the Dolet Hills plant after its retirement is similar to that applicable to the undepreciated value of SWEPCO's retired gas-fired plants discuss above. For ease of reference, that analysis is contained here in this section, as well. PURA § 36.051 directs the Commission to permit "the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of the utility's reasonable and necessary operating expenses." This directive is a positive statement of the Commission's obligation to provide a reasonable return on invested capital "used and useful" in providing service. However, this directive does not forbid the Commission from recognizing that there is a cost of financing investment in a generation asset that is prudently retired with undepreciated value. In other words, the statute is silent regarding a return afforded to an investment in a generation facility that the Commission views as no longer used after retirement, other than requiring the Commission permit recovery of the "utility's reasonable and necessary operating expenses."

Consistent with this reading of PURA § 36.051, the Commission has recognized its

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<sup>65</sup> SWEPCO Ex. 36 at 26:19-27:5.

<sup>66</sup> PFD at 25 (footnote omitted).

statutory authority to “balance equities” when setting cost recovery for assets that may no longer be considered used or useful. In addressing ECOM, also known as stranded costs, ahead of the introduction of unbundled, competitive generation in Texas, the Commission recognized its authority to allow recovery of the cost to finance such assets:

In its mandated role as a substitute for competition, the Commission pursuant to PURA § 2.203 [predecessor to § 36.051] must in each rate proceeding set overall revenues at a level to provide a reasonable opportunity to earn a reasonable return on invested capital used and useful in rendering service. ECOM is inherently economically unuseful, or at a minimum less useful, in rendering service. Under the “used” standard applied in past cases, the Commission exercised its authority to balance equities by allowing recovery of capital costs while eliminating or reducing the return on those assets that have been found prudent, but that are not used to provide service. The same rationale may be consistently applied when assets are unuseful.<sup>67</sup>

The Commission did not view itself constrained by an “either/or” choice of allowing a traditional regulated return or no cost of financing at all. Instead, the Commission allowed a traditional return on non-ECOM invested capital, while still recognizing that there are costs associated with financing ECOM.<sup>68</sup>

Further, as noted in the section above, the Hawaii Public Utilities Commission has addressed similar circumstances, recognizing that a carrying cost is an appropriate cost of service regarding the undepreciated value of retired property:

We agree with GASCO that allowing a carrying charge on the unamortized balance of the value of retired or abandoned property is not equivalent to providing a rate of return on a rate base that is nonexistent as argued by the CA. Once it is determined that the undepreciated value of retired or abandoned property should be allowed to be amortized over a reasonable period, it is but a short step to allowing a carrying charge, on the unamortized balance, that relates to the cost of debt issued for the construction of retired or abandoned property, so long as the retirement or abandonment before the end of the property’s useful life has been amply justified. The recovery allowed is recovery of all of the unrecovered cost of the property. We, thus, allow a carrying charge of 8.46 per cent per annum.<sup>69</sup>

Also, as noted in the section above, the Oklahoma Corporation Commission took the same path for a generating unit retired by SWEPCO’s sister AEP operating company, PSO. Despite the

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<sup>67</sup> Docket No. 14965, Second Order on Rehearing at 2 (Word doc) (emphasis omitted).

<sup>68</sup> Docket No. 14965, Second Order on Rehearing at 3 (Word doc).

<sup>69</sup> *Re Gasco, Inc.*, 132 P.U.R.4th 352 (Hawaii P.U.C. Apr. 3, 1992).

fact that the Oklahoma commission embraces the “used and useful” ratemaking concept, that Commission allowed a carrying charge on the undepreciated value of PSO’s retired coal-fired Northeastern Unit 4 (NE 4): “In balancing the interests of ratepayers and shareholders, THE COMMISSION FINDS it appropriate under the circumstances presented here to authorize a return of the investment associated with NE 4 and recovery of the carrying cost on the remaining investment at the cost of debt allowed in this proceeding.”<sup>70</sup> Just as SWEPCO’s Dolet Hills plant, PSO’s NE 4 provided service to customers for more than 35 years.<sup>71</sup>

That the Dolet Hills plant will be retired with significant undepreciated value is not the result of actions taken or not taken by SWEPCO. The rate history of the Dolet Hills plant demonstrates this fact. In Docket No. 40443, SWEPCO identified a 40-year service life for the Dolet Hills plant to match the availability of fuel at the plant.<sup>72</sup> Instead, the Commission ordered the plant be depreciated over a 60-year service life.<sup>73</sup> The fact is that, under the PFD’s proposal, SWEPCO’s opportunity to earn a reasonable return on capital prudently invested in generation plant will not depend on SWEPCO’s prudent management of its business. Instead, SWEPCO’s opportunity to earn a reasonable return on capital prudently invested in generation assets will be denied because Commission-approved depreciation rates will not fully recover the value of that prudent investment by the time that the Dolet Hills plant is prudently retired. To deny any carrying cost at all on the undepreciated value of a retired generation asset regardless of the circumstances of that investment and subsequent retirement provides inappropriate incentives to parties in utility rate cases to recommend the Commission extend the depreciable lives of generation units in an effort to cause unit retirements with excessive undepreciated value.<sup>74</sup>

It is undisputed that SWEPCO’s investment in the Dolet Hills plant was reasonable and necessary to provide service to customers and that SWEPCO has incurred a cost to finance that investment. Given that the Dolet Hills plant will be prudently retired after serving the public for more than 35 years and that the plant provided service to customers for 25 years before the costs

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<sup>70</sup> Oklahoma Corporation Commission Cause No. PUD 201700151, Final Order (Order No. 672864) at 3.

<sup>71</sup> Oklahoma Corporation Commission Cause No. PUD 201700151, ALJ Report at FoF No. 54 (Dec. 11, 2017).

<sup>72</sup> *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, PFD at 173-74 (May 20, 2013).

<sup>73</sup> Docket No. 40443, Order on Rehearing at FoF No. 198 (Mar. 6, 2014).

<sup>74</sup> SWEPCO Ex. 36 at 27:8-12.

associated with the plant were placed into base rates, it is appropriate for the Commission to recognize that SWEPCO's full weighted average cost of capital has financed these assets. At the least, the Commission should afford SWEPCO recovery of its average cost of debt on the undepreciated value of the Dolet Hills plant once it is retired, thereby avoiding a punitive write down of a portion of that prudent, reasonable, and necessary investment.

If the Commission denies SWEPCO's primary exceptions regarding the rate treatment for SWEPCO's undepreciated investment in the Dolet Hills plant upon its retirement (addressed above in Section V.A.2.a.), SWEPCO requests that Findings of Fact Nos. 60 and 64 be rejected and the following findings be adopted to both (1) correct errors in the number running structure of the Dolet Hills rider and (2) provide SWEPCO with a reasonable amount of carrying cost on the undepreciated value of the Dolet Hills plant upon its retirement:

- Both the ADFIT and unused M&S associated with the Dolet Hills plant are a proper element of the net book value of the Dolet Hills plant and should be accounted for in the Dolet Hills Rate Recovery Rider.
- The demolition costs associated with the Dolet Hills plant after its retirement is a proper element of the net book value of the Dolet Hills plant and should be accounted for in the Dolet Hills Rate Recovery Rider.
- Amortization of SWEPCO's investment in the Oxbow lignite reserves beginning in 2022 should be removed from the Dolet Hills Rate Recovery Rider because these costs are recovered as an element of fuel costs.
- The Dolet Hills Rate Recovery Rider that will be filed by SWEPCO in a subsequent compliance filing should include a provision that contains a true-up mechanism for the actual elements of the Dolet Hills remaining net book value at the time of retirement and actual demolition costs.
- It is undisputed that SWEPCO's investment in the Dolet Hills plant was reasonable and necessary to provide service to customers and that SWEPCO incurred a cost to finance that investment.
- Given that the Dolet Hills plant will be prudently retired at the end of 2021 after serving the public for more than 35 years, it is appropriate for the Commission to recognize that SWEPCO's full weighted average cost of capital has financed these assets.
- [In the alternative to the above] The Commission affords SWEPCO recovery of its average cost of debt on the undepreciated value of the Dolet Hills plant after its

retirement, thereby avoiding a write down of a portion of that prudent, reasonable, and necessary investment.

**C. NOLC ADFIT and Excess ADFIT**

**NOLC ADFIT (Exception to FoF Nos. 80-83)**

In this rate case, SWEPCO reduced its ADFIT balance by the NOLC it incurred as the result of accelerated depreciation taken in past tax years. The PFD rightfully recognizes that SWEPCO's proposed treatment is consistent with Texas law and not controversial on its face.<sup>75</sup> The PFD observes that "SWEPCO and Staff agree, at least in concept, that SWEPCO is required to calculate its income-tax expense (including ADFIT) on a stand-alone basis – *i.e.*, reflecting only SWEPCO's own benefits and burdens in providing service to its customers, without commingling any tax benefits obtained by its affiliates."<sup>76</sup> In fact, the PFD acknowledges that this stand-alone calculation of taxes and ADFIT is required by PURA § 36.060. However, Commission Staff took issue with the fact that SWEPCO received a consolidated tax benefit when it received cash payments from its affiliates (via AEP) for using SWEPCO's NOLC in AEP's consolidated federal income tax returns. These payments, Staff argued, would result in double counting the NOLC in rate base – once as an offset to ADFIT and again as a cash infusion used to pay for rate base items. Staff confuses rate base with the cash used to pay for rate base and operations and maintenance expenses. The PFD reflects this same misunderstanding:

Thus, because the amount of the tax-allocation payments is now part of SWEPCO's rate base, it follows that SWEPCO's NOLC ADFIT adjustment would duplicate rather than preserve the rate impact of the NOLC ADFIT. In addition to the \$455,122,490 now in rate base that SWEPCO received in exchange for the NOLC ADFIT, SWEPCO's rate base would be increased by \$455,122,490 again, through the adjustment's offsetting of ADFIT by that amount. Nothing in PURA 36.060 requires this double-counting, and allowing it would also violate normalization principles by doubling the rate impact of the NOLC ADFIT. Staff's proposal preserves the correct rate impact of the NOLC ADFIT now that the tax-allocation payments are in rate base.<sup>77</sup>

The term "rate base" is defined in the Commission's Cost of Service rule as those assets – "plant,

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<sup>75</sup> PFD at 80.

<sup>76</sup> PFD at 80.

<sup>77</sup> PFD at 89-90.

property, and equipment” – that are used and useful in providing service to the public.<sup>78</sup> The tax allocation payments received by SWEPCO are not plant, property, and equipment used to provide service to the public and do not themselves constitute rate base. Instead, those payments are cash, which allows the utility to avoid issuing debt and equity to maintain cash reserves. The PFD is simply wrong in finding that “the tax-allocation payments are in rate base.”

The PFD’s recommendation to remove SWEPCO’s stand-alone NOLC ADFIT from rate base fails for two reasons, both of which are discussed in more detail below. First, there is no “double counting” of the NOLC in rate base under SWEPCO’s proposal. There is no evidence in the record to support such a conclusion because no item of rate base was included in rate base twice. SWEPCO’s tax witness, Mr. Dave Hodgson, specifically testified on this issue.<sup>79</sup> Mr. Hodgson even provided a hypothetical to emphasize the point, as discussed further below.<sup>80</sup> Staff offered no such evidence, but instead made bare assertions.

Second, adoption of the PFD’s recommendation would likely lead to a violation of IRS normalization requirements.<sup>81</sup> Administratively, only the IRS, not the ALJs or the Commission, has the authority to determine a normalization violation. SWEPCO is preparing to request a Private Letter Ruling from the IRS based on the PFD’s recommendation to remove SWEPCO’s stand-alone NOLC ADFIT from the calculation of rate base. Therefore, at the very least, the final order issued in this proceeding should allow SWEPCO a means to avoid an unintended normalization violation. The PFD’s bold proclamation that the disallowance of SWEPCO’s adjustment would not lead to a normalization violation without input from the IRS and a means to correct the potential normalization violation puts SWEPCO and its customers at too great a risk.

That risk is very real. If, as SWEPCO expects, the IRS determines that a normalization violation results from excluding the NOLC ADFIT from rate base, then SWEPCO would no longer be able to use accelerated depreciation on any property used to provide regulated service in Texas.<sup>82</sup> Moreover, deferred taxes resulting from accelerated depreciation used in prior years would be due sooner. This means a normalization violation would result in higher utility rates for

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<sup>78</sup> 16 TAC § 25.231(c)(2).

<sup>79</sup> Rebuttal Testimony of David A. Hodgson, SWEPCO Ex. 45 at 14:1-19:2.

<sup>80</sup> SWEPCO Ex. 45 at 14:1-19:2.

<sup>81</sup> SWEPCO Ex. 45 at 5:6-6:10; *see also* Rebuttal Testimony of Bradley M. Seltzer, SWEPCO Ex. 44 at 9:6-13.

<sup>82</sup> Direct Testimony of David A. Hodgson, SWEPCO Ex. 17 at 15:14-16:8; *see also* SWEPCO Ex. 44 at 9:7-9.

customers because there would be no ADFIT relating to accelerated depreciation available to offset rate base for customers.<sup>83</sup>

If the Commission were inclined to accept the PFD's recommendation to remove SWEPCO's stand-alone NOLC ADFIT from the calculation of rate base, SWEPCO offers two alternative ordering paragraphs that will mitigate the risk of an unintended normalization violation while the PLR process plays out at the IRS. First, the Commission could authorize SWEPCO to implement rates reflective of the inclusion of the stand-alone NOLC ADFIT in the calculation of rate base subject to refund if the IRS determines that removal of the NOLC ADFIT from the calculation of rate base will not constitute a normalization violation. In the alternative, the Commission could authorize SWEPCO to establish a regulatory asset for the return that would be associated with the inclusion of the stand-alone NOLC ADFIT in the calculation of rate base. That regulatory asset would be written-off and not recovered from customers if the IRS determines that removal of the NOLC ADFIT from the calculation of rate base will not constitute a normalization violation. With either alternative, the risk of an unintended normalization violation will be mitigated and customers will be made whole consistent with the IRS's determination. These alternatives are discussed further below.

#### **There is no Double Counting**

SWEPCO's proposal does not result in a double counting of the NOLC as stated in the PFD. The PFD is simply wrong. While it is true that SWEPCO received cash payments from its affiliates for use of the NOLC under the AEP consolidated tax sharing agreement, those cash payments were not used to increase rate base by \$455,122,490. Instead, those cash payments reduced the issuance of additional debt and equity. SWEPCO's rate base represents only those assets that are used and useful in providing utility service.<sup>84</sup> SWEPCO may have used the cash payments instead of debt or equity infusions from its parent, but the ultimate rate base balance was not increased beyond what was prudent for SWEPCO to provide service. Pursuant to the *Hope* and *Bluefield* cases<sup>85</sup> and PURA § 36.051, SWEPCO should be allowed to recover a reasonable return on its investment whether that investment is funded by debt or equity (including payments

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<sup>83</sup> SWEPCO Ex. 17 at 15:14-16:8; *see also* SWEPCO Ex. 44 at 9:7-9.

<sup>84</sup> SWEPCO Ex. 45 at 14:15-15:5.

<sup>85</sup> *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923).

from affiliates). There is no finding in the record that SWEPCO acted imprudently, or included unnecessary items in its rate base used to provide service to the public. The PFD incorrectly confuses rate base with the source of the funds used to invest in rate base. No matter the origin of the funds, the analysis should be the same.

SWEPCO's tax witness, Mr. Dave Hodgson, further illustrates this point on pages 14 through 19 of his rebuttal testimony. Mr. Hodgson shows that SWEPCO's proposal would result in the same return on rate base as a company with no tax allocation agreement and no resulting cash payments. He further shows that Staff's proposal (and consequently the PFD) would result in a decrease in SWEPCO's return on rate base used to provide service to the public. That is, the tax allocation payments do not incrementally increase rate base, but rather substitute for the issuance of additional debt and equity. The prudent rate base amount is set. The NOLC tax allocation payments do not increase the rate base amount. If there were no cash payments, SWEPCO would have been required to get that money from some other source (*i.e.*, debt or equity). In the end, the cash allocation payments are no different than an equity infusion from SWEPCO's parent for which the equity investor should be compensated with an applicable return.

The PFD incorrectly concludes that the tax allocation payments somehow contaminate a portion of rate base such that SWEPCO's NOLC should not be used to offset ADFIT.<sup>86</sup> Again, this conclusion is wrong. If the AEP consolidated tax sharing agreement provided for no tax allocation payments, or instead provided that the NOLC tax allocation payments should flow to AEP (the parent) instead of SWEPCO, the rate base amount would be the same and there would be no controversy around SWEPCO's proposed NOLC ADFIT adjustment. Staff acknowledges, and the PFD agrees, that but for SWEPCO's receipt of the tax allocation payments there would be no dispute.<sup>87</sup> However, the PFD does not extend this rationale to its logical conclusion. SWEPCO's proposal, and the resulting rate base impact, is the exact same as if there were no tax allocation payments. The PFD's recommendation to remove SWEPCO's stand-alone NOLC ADFIT from rate base simply because of the tax allocation payment results in "commingling . . . tax benefits obtained by its affiliates," something that the PFD freely admits is prohibited by PURA § 36.060.

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<sup>86</sup> PFD at 90.

<sup>87</sup> PFD at 81.

The PFD extends this error in providing that, “[t]he tax-allocation payments, in contrast, represent cash from SWEPCO’s affiliates (and, in turn, the affiliates’ customers) exchanged for the use of SWEPCO’s NOLC ADFIT in reducing the affiliates’ taxes and their customers’ cost of service.” Again, the PFD is wrong. The tax-allocation payments do not reduce the affiliates’ taxes, nor do they impact the affiliates’ cost of service. The affiliates still have to pay their tax bill to the AEP consolidated group (as if they were paying it to the IRS) under the tax sharing agreement. The affiliates’ cost of service calculations likewise are not reduced by the tax-allocation payments, but are calculated on a stand-alone basis – just like SWEPCO. The receipt or payment of a distribution through the tax sharing agreement is entirely outside the scope of the regulated operations of the company.

Moreover, there is no double counting of the NOLC because the NOLC still exists on a stand-alone basis for future ratemaking purposes. That is, the NOLC will absorb and reduce current taxes in future periods until the NOLC is reduced to zero on a stand-alone basis. As explained through witness testimony and summarized in the PFD, SWEPCO computed its NOLC on a stand-alone basis.<sup>88</sup> SWEPCO also calculated its tax expense (including ADFIT), depreciation, and rate base on a stand-alone basis. The PFD even recognizes that the stand-alone approach is proper under PURA § 36.060.<sup>89</sup> However, the PFD incorrectly ignores SWEPCO’s stand-alone NOLC and the long-term impact of that NOLC in reducing current tax expense in future years as that NOLC is reduced over time on a stand-alone basis. The PFD erroneously ignores the stand-alone tax calculation requirements of PURA § 36.060 by eliminating one component (the NOLC) from SWEPCO’s stand-alone tax calculation. Simply stated, the PFD violates PURA § 36.060 by including a consolidated tax benefit in the calculation of SWEPCO’s cost of service.

### **Normalization**

The Commission should reject the PFD recommendation regarding the NOLC ADFIT issue simply based on the stand-alone requirements of PURA § 36.060 discussed above. In so doing, the Commission would avoid putting the Company in a position that likely violates IRS normalization rules. If the Commission does not reject the PFD recommendation regarding the

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<sup>88</sup> PFD at 80-81.

<sup>89</sup> PFD at 80-81.

NOLC ADFIT issue, then both SWEPCO and its customers could be negatively impacted. SWEPCO requests that the Commission protect SWEPCO's customers against that negative impact.

In addition to violating PURA § 36.060, the PFD further errs because it incorrectly assumes that its denial of SWEPCO's NOLC ADFIT adjustment would not result in a normalization violation.<sup>90</sup> Both SWEPCO tax witnesses, Mr. Dave Hodgson and its normalization expert, Mr. Bradley Seltzer, testified that denial of SWEPCO's NOLC ADFIT adjustment would likely result in a normalization violation under the IRS's consistency requirements.<sup>91</sup> Under the consistency requirements, depreciation expense, tax expense, ADFIT, and rate base should all consistently be calculated on the same basis. Since tax expense, depreciation expense, and rate base are all calculated on a stand-alone basis, it follows that ADFIT must also be calculated on a stand-alone basis. By denying SWEPCO's NOLC ADFIT adjustment, the PFD recommends that SWEPCO's ADFIT not be calculated on a stand-alone basis even though many IRS rulings provide otherwise.<sup>92</sup>

The PFD cites the testimony of SWEPCO's witnesses, but ignores their expertise in this field.<sup>93</sup> Instead, the PFD relies on one IRS revenue procedure that provides commissions should have some flexibility in determining the amount of NOLC attributable to accelerated depreciation.<sup>94</sup> The PFD further points out that there is no specific letter ruling directly addressing SWEPCO's fact pattern.<sup>95</sup> Based on these two pillars, the PFD concludes that denial of SWEPCO's NOLC ADFIT adjustment would not result in a normalization violation. The PFD reasons that IRS normalization rules cannot support a double counting of SWEPCO's NOLC.

The PFD goes too far. As addressed above, SWEPCO's proposed NOLC ADFIT adjustment would not result in a double counting of the NOLC. Moreover, the PFD recommends inconsistent treatment of the NOLC ADFIT to counteract an alleged "double counting" that does

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<sup>90</sup> PFD at 90.

<sup>91</sup> SWEPCO Ex. 45 at 4:14-6:10; see also SWEPCO Ex. 44 at 9:6-13.

<sup>92</sup> SWEPCO Ex. 17 at Exhibit DAH-1 through Exhibit DAH-7; *see also* SWEPCO Ex. 44 at Exhibit BMS-1R and Exhibit BMS-2R.

<sup>93</sup> PFD at 85-89.

<sup>94</sup> PFD at 90.

<sup>95</sup> PFD at 90.

not exist, and then concludes that such treatment does not violate “consistency” rules. At the very least, the PFD should recommend that SWEPCO (with Staff’s participation) seek a private letter ruling (PLR) directly from the IRS. The consequences of a normalization violation are too extreme<sup>96</sup> to take a chance based on one general statement in an IRS revenue procedure that does not directly address the issue in this case. If the plethora of clearly relevant PLRs provided in support of SWEPCO’s position are inadequate to support the requested NOLC ADFIT adjustment, then surely one generic statement in one revenue procedure addressing excess deferred taxes is also inadequate to support the PFD.

To protect SWEPCO and its customers, if the Commission adopts the PFD’s recommendation, the Commission should also adopt one of two alternative ordering paragraphs outlined below in these exceptions to ensure that there is not an unintended normalization violation. The consequences of a normalization violation are too significant to be unaddressed.

#### **Excess ADFIT**

The PFD concludes, since it recommends excluding the NOLC ADFIT from the rate base calculation, the NOLC should likewise be removed from the calculation of excess ADFIT (resulting from the TCJA) that is available to be returned to customers.<sup>97</sup> That is, the same analysis should apply to both issues. However, Mr. Hodgson’s testimony clearly shows that excluding the NOLC from the excess ADFIT calculation would result in SWEPCO’s customers receiving more in excess deferred taxes than they originally paid.<sup>98</sup> In effect, SWEPCO’s customers would be returned taxes paid by the customers of SWEPCO’s affiliates. This additional fact alone is enough to support inclusion of the NOLC related ADFIT in the excess ADFIT calculation.

Notwithstanding the above issue, to the extent the Commission reverses the PFD recommendation regarding SWEPCO’s proposed NOLC ADFIT adjustment, the calculation of excess ADFIT should likewise be adjusted. Moreover, any adjustment resulting from an IRS determination that the PFD’s NOLC ADFIT recommendation would result in a normalization violation should likewise include a corresponding change in excess ADFIT available to be returned to customers.

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<sup>96</sup> PFD at 79.

<sup>97</sup> PFD at 91-92.

<sup>98</sup> SWEPCO Ex. 45 at 21:7-24:13.

### **Mitigating the Risk of an Unintended Normalization Violation**

As discussed above, removing SWEPCO's stand-alone NOLC ADFIT from the calculation of rate base violates PURA's directive that income-tax expense (including ADFIT) be calculated on a stand-alone basis without commingling any tax benefits obtained by SWEPCO's affiliates. Further, removing that stand-alone NOLC ADFIT from the calculation of rate base likely constitutes a normalization violation. SWEPCO requests that the Commission take action to mitigate the risk of an unintended normalization violation and the damage such a violation could impose on SWEPCO's customers. In either of the alternatives identified below, customers will be made whole, consistent with the IRS's determination. As a means to protect SWEPCO's customers from unintended consequences, if the Commission were to adopt the PFD's recommendation to remove SWEPCO's stand-alone NOLC ADFIT from the calculation of rate base and the related excess ADFIT amortization in the cost of service, SWEPCO requests that the Commission adopt one of two alternative ordering paragraphs in its final order.

(1) Notwithstanding Finding of Fact Nos. 80-83, SWEPCO is authorized to implement rates reflective of its stand-alone NOLC ADFIT in the calculation of rate base. In addition, SWEPCO is authorized to implement rates reflective of the stand-alone NOLC excess ADFIT in the calculation of the net excess ADFIT amortization in the cost of service. The rates reflective of the stand-alone NOLC are subject to refund if the IRS determines that the removal of that stand-alone NOLC ADFIT from the calculation of rate base does not constitute a normalization violation;

### ***In the Alternative***

(2) Notwithstanding Finding of Fact Nos. 80-83, SWEPCO is authorized to establish a regulatory asset for the return that would be associated with inclusion of SWEPCO's stand-alone NOLC ADFIT in the calculation of rate base, as well as the net excess amortization of excess ADFIT in the calculation of the cost of service, with an effective date equal to that of the rates being implemented in this proceeding – March 18, 2021. SWEPCO will be eligible to request recovery of that regulatory asset once it receives an IRS determination that removal of the stand-alone NOLC ADFIT from the calculation of rate base constitutes a normalization violation. If the IRS determines that such removal does not constitute a normalization violation, the regulatory asset will be written-off and not recovered from customers.

Even if the Commission were to disagree with SWEPCO as to whether the PFD's recommendation would constitute a normalization violation, prudence requires that the Commission take steps

necessary to avoid the adverse consequences to customers of a normalization violation.

**E. Regulatory Assets and Liabilities (Exceptions to FoF No. 96 and CoL No. 30)**

**1. Self-Insurance Reserve**

SWEPCO excepts to the PFD's recommendation that the Commission reject the Company's proposed self-insurance reserve for storm expenses. The PFD's recommendation is based on a faulty standard not contained in the Commission's rule and ignores undisputed expert testimony that self-insurance is more cost-effective than commercial insurance. The Commission should reject the PFD's recommendation and approve the Company's proposed self-insurance reserve.

In addition to its faulty recommendation to deny the Company's requested self-insurance reserve, the PFD's proposed storm expense adjustment based on its self-insurance recommendation is wrong. If the Commission accepts the PFD's self-insurance recommendation, it should correct the accompanying erroneous rate adjustment.

As an initial matter, the Commission has approved self-insurance reserves for other Texas utilities that are very similar to the reserve proposed by SWEPCO. The Company's insurance expert witness, Greg Wilson, was also the expert witness in those cases. For example, in AEP Texas' last rate case, Docket No. 49494, the Commission found that AEP Texas' self-insurance reserve was in the public interest, was a lower-cost alternative to purchasing commercial insurance, and resulted in savings that benefit ratepayers, in accordance with PURA § 36.064 and 16 TAC § 25.231(b)(1)(G).<sup>99</sup> In CenterPoint's last rate case, Docket No. 49421, the Commission also approved a storm reserve based on similar findings.<sup>100</sup> Texas-New Mexico Power Company also has a self-insurance reserve based on this analysis,<sup>101</sup> as do Entergy Texas<sup>102</sup> and Oncor.<sup>103</sup> While

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<sup>99</sup> *Application of AEP Texas Inc. for Authority to Change Rates*, Docket No. 49494, Final Order at FoF Nos. 150-151, Conclusion of Law (CoL) No. 15 (Apr. 6, 2020).

<sup>100</sup> *Application of CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*, Docket No. 49421, Final Order at FoF Nos. 111-112 (Mar. 9, 2020).

<sup>101</sup> *Application of Texas-New Mexico Power Company for Authority to Change Rates*, Docket No. 48401, Final Order at FoF Nos. 81-82 (Dec. 20, 2018).

<sup>102</sup> *Entergy Texas, Inc. 's Statement of Intent and Application for Authority to Change Rates*, Docket No. 48371, Final Order at FoF Nos. 89-90, CoL No. 13 (Dec. 20, 2018).

<sup>103</sup> *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing at FoF No. 98, CoL No. 18 (Nov. 30, 2009).

many of these cases were settled, the fact remains that most Texas utilities have self-insurance reserves very similar to SWEPCO's proposal, based on Commission findings that such reserves are in the public interest, provide a lower-cost alternative to commercial insurance, and result in savings to ratepayers.

The PFD's recommendation is based on a faulty standard not contained in the Commission's self-insurance rule. The PFD's key conclusion is that "[i]n the very least, the [Company's] analysis would need to demonstrate why or how the cost of commercial insurance would exceed the specific costs of SWEPCO's proposal, which are not inconsiderable and include establishing a reserve that more than doubles the annual cost levels."<sup>104</sup> This requirement is not contained in the Commission's rule and demonstrates that the PFD misunderstood the operation of a self-insurance reserve. The accruals to build and maintain the self-insurance reserve are *not* costs, as the PFD seems to assume, but are akin to escrow payments that build a reserve for future storm costs. Costs are not incurred until storms occur that are charged against the reserve. The PFD's suggested comparison between annual storm reserve accruals and commercial insurance costs is faulty. Commercial insurance premiums are fixed annual costs while accruals build a reserve that will only be used when storm costs actually arise. The Commission's self-insurance rule does not require the PFD's suggested comparison between annual self-insurance accruals and commercial insurance premiums because such a comparison is not meaningful or valid.

Undisputed testimony by SWEPCO's expert insurance witness, Mr. Wilson, establishes that commercial insurance includes costs not required for a self-insurance reserve. As Mr. Wilson testified, commercial insurance includes costs for losses, loss adjustment expenses, non-loss related expenses, commissions, taxes and profit, while a self-insurance reserve does not incur many of these costs.<sup>105</sup> The reserve will incur costs for losses as storm costs are subsequently charged against the reserve but will not incur insurance company costs or profit. It is almost self-evident, but fully supported by Mr. Wilson's expert testimony, that commercial insurance includes costs and profit that are not incurred by a self-insurance reserve. Despite undisputed evidence that self-insurance is more cost-effective than commercial insurance, the PFD recommends denial of SWEPCO's request to establish such a reserve.

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<sup>104</sup> PFD at 100 (emphasis added; footnote omitted).

<sup>105</sup> Direct Testimony of Gregory S. Wilson, SWEPCO Ex. 28 at 11:1-18.

Moreover, the Commission's rules also address the carrying cost (time value of money) of putting aside a reserve for storm damages by requiring that a utility's rate base be adjusted based on its reserve balance.<sup>106</sup> As a result, if the Company's storm reserve has a positive balance (accruals exceed eligible storm costs), the Company's rate base and return on that rate base will be reduced, crediting customers for the carrying value of the reserve.

The PFD appears to hang up on the fact that SWEPCO did not present a specific commercial insurance quote as part of its cost-benefit analysis, despite Mr. Wilson's testimony that commercial insurance includes costs and profit not required for a self-insurance reserve,<sup>107</sup> that private insurance continues to be prohibitively expensive, and that he confirmed his understanding with SWEPCO shortly before filing his testimony.<sup>108</sup> However, as discussed above, the PFD's simplistic proposal to compare self-insurance accruals to commercial insurance premiums is not valid because premiums are fixed costs while accruals are not, but instead build a reserve to apply to future storm costs. Unlike the PFD's false comparison, Mr. Wilson's analysis of a self-insurance reserve versus the additional costs and profits that are embedded in commercial insurance premiums properly compares the relative costs and benefits of the two alternatives.

Finally, the PFD's proposed storm expense adjustment based on its rejection of a self-insurance reserve is also wrong. The Company's rate filing contained two adjustments related to its proposed self-insurance reserve: 1) removal of all test year actual storms greater than \$500,000 (the threshold for storms that would be charged against the reserve), which reduced total company cost of service by \$6.4 million; and 2) addition of \$1.7 million to cost of service for the annual storm accrual.<sup>109</sup> The number runs accompanying the PFD only removed the second element, the annual \$1.7 million storm reserve accrual. If the PFD's proposed rejection of the self-insurance reserve is adopted by the Commission, the \$6.4 million of test year storm costs should be restored given that no party challenged SWEPCO's test year storm costs.

To correct the PFD's faulty self-insurance recommendation, the Commission should modify Finding of Fact 96; add Findings of Fact 96A, 96B, and 96C; modify Conclusion of Law

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<sup>106</sup> See 16 TAC § 25.231(c)(2)(E) ("If a self insurance plan is approved by the commission, any shortages to the reserve account will be an increase to the rate base and any surpluses will be a decrease to the rate base.").

<sup>107</sup> SWEPCO Ex. 28 at 11:1-18.

<sup>108</sup> Tr. at 289-290 (Wilson Cross) (May 19, 2021).

<sup>109</sup> SWEPCO Ex. 6 at 31:4-20.

30; and add Conclusion of Law 30A, as follows:

- 96. SWEPCO's cost-benefit analysis demonstrates that, with consideration of all costs, self-insurance is a lower-cost alternative than commercial insurance and that customers will receive the benefits of the self-insurance plan.
- 96A. SWEPCO's proposed self-insurance reserve is in the public interest.
- 96B. SWEPCO's proposed annual accrual of \$1,689,700 to the storm reserve is reasonable. The annual accrual of \$1,689,700 accounts for annual expected operations and maintenance losses from storm damage in excess of \$500,000 and builds towards a target reserve of \$3,560,000.
- 96C. In future rate filings, consistent with 16 TAC § 25.231(c)(2)(E), SWEPCO will treat the reserve amount as a reduction to its Texas jurisdictional rate base if the amounts credited to the reserve exceed the charges against the reserve and will treat the reserve amount as an addition to its Texas jurisdictional rate base if the charges against the reserve exceed the amounts credited to the reserve.
- 30. SWEPCO met its burden of proof to show that its proposed self-insurance reserve would be in the public interest. Tex. Util. Code § 36.064(b); 16 TAC § 25.231(b)(1)(G).
- 30A. SWEPCO's self-insurance plan with an annual accrual of \$1,689,700 and a target reserve amount of \$3,560,000 is in accordance with PURA § 36.064 and 16 TAC § 25.231(b)(1)(G).

The Commission should also add Ordering Paragraph 2A as follows:

- 2A. SWEPCO must accrue the self-insurance reserve accrual amount approved by this Order until modified by a Commission order in a subsequent proceeding.

## **2. Hurricane Laura Costs**

In its rate filing, SWEPCO requested authorization to charge its Texas jurisdictional Hurricane Laura restoration costs against the self-insurance reserve for which it seeks approval. As the PFD notes, no party opposed this request aside from their opposition to the self-insurance reserve itself.<sup>110</sup> For the reasons discussed above, the Commission should reject the PFD's recommendation and approve a self-insurance reserve for SWEPCO, as it has for most other Texas utilities. The Commission should also approve the Company's proposal to charge Hurricane Laura costs against the reserve.

To correct the PFD's faulty recommendation, the Commission should add Finding of Fact

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<sup>110</sup> PFD at 101.

96D and Ordering Paragraph 2B as follows:

- 96D. SWEPCO's proposal to charge its Texas jurisdictional Hurricane Laura costs against the self-insurance reserve is approved.
- 2B. SWEPCO must charge the Texas jurisdictional Hurricane Laura restoration costs against the self-insurance reserve consistent with its proposal in this case.

## VI. RATE OF RETURN

### A. Return on Equity (Exception to FoF Nos. 97-99, and 105)

The PFD recommends a 9.45% return on equity (ROE) for SWEPCO. In describing their rationale for the recommended ROE, the ALJs state:

Taking these analyses into consideration, weighted as described, a reasonable range for SWEPCO's ROE would be from 9.0% on the low end to 9.9% on the high end. Given that there is no clear indicator within the economic, subjective group of factors, the ALJs conclude that a mid-point of this range is the best approximation of the appropriate ROE for SWEPCO. In this case, the point would be 9.45%, which the ALJs recommend the Commission adopt.<sup>111</sup>

The PFD's ROE recommendation is also reflected in FoF Nos. 97-99, 105 and Conclusion of Law (CoL) No. 17.<sup>112</sup> The PFD concludes that the mathematical analyses and computations submitted by the experts suggest a reasonable ROE range between 9% and 9.9% with a midpoint of 9.45%. SWEPCO respectfully disagrees. The objective evidence indicates that the higher end of the reasonable ROE range should be 10.2% at the very least.<sup>113</sup> A 10.2% ROE represents the very low end of Mr. D'Ascendis' recommended range provided in his rebuttal testimony even after excluding his analyses involving the non-regulated proxy group and the PRPM. Based on this adjusted reasonable ROE range of 9% to 10.2%, a midpoint ROE of 9.6% more accurately reflects the accepted analyses of all the testifying witnesses.

In order to meet the familiar constitutional standards established by the *Hope* and *Bluefield* decisions, the approved ROE should be comparable to similarly situated entities, ensure sound operations, and allow SWEPCO to attract capital so that it can provide safe, reliable service.

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<sup>111</sup> PFD at 146.

<sup>112</sup> SWEPCO excepts to FoF Nos. 97-99, and 105 and respectfully requests that these findings be amended to reflect a 9.6% ROE. CoL No. 17 need not be revised because it does not expressly reference the recommended ROE percentage.

<sup>113</sup> See Rebuttal Testimony of Dylan W. D'Ascendis, SWEPCO Ex. 38 at Exhibit DWD-1R.

Investors have choices. When investors see other comparable utilities with higher authorized ROEs than SWEPCO, they have the option to pursue the higher return on investment offered by those other utilities, rather than SWEPCO.

Citing *Hope* and *Bluefield*, the PFD rightly points out that the United States Supreme Court has set forth a minimum constitutional standard governing equity returns for utility investors. This longstanding precedent establishes that a utility must have a reasonable opportunity to: 1) earn a return commensurate with investments of comparable risk, 2) ensure financial soundness, and 3) attract capital at reasonable rates. The PFD's recommended 9.45% ROE does not meet these standards.

The purpose of these exceptions is not to restate or summarize the respective positions of SWEPCO, Staff, or the interveners. The PFD does that quite well. Rather, these exceptions will show that, taking a step back, the 9.45% ROE recommendation is simply too low. It does not meet the minimum standards of *Hope* and *Bluefield*. Accordingly, SWEPCO respectfully requests that the PFD be amended to reflect a ROE no lower than 9.6%,<sup>114</sup> which is the midpoint of the recommended range after removing Mr. D'Ascendis' non-regulated proxy group and PRPM analyses. Moreover, a minimum 9.6% ROE would put SWEPCO closer to similarly situated utilities across the country thereby allowing it to attract capital, maintain credit, and earn a return commensurate with investments of comparable risk.

**The PFD recommended 9.45% ROE is not commensurate with returns on equity investments in enterprises having comparable risks**

The proxy groups used by the experts in this case provide a good comparison for purposes of ROE. That is, each expert selected their own proxy group and determined that the entities included therein have comparable risk to SWEPCO.<sup>115</sup> Mr. D'Ascendis' utility proxy group included fourteen vertically integrated electric utilities.<sup>116</sup> TIEC witness Gorman used a similar

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<sup>114</sup> The Commission has the authority to select amounts within the range of reasonable options supported by the record evidence. *See City of El Paso v. Pub. Util. Comm'n of Tex.*, 883 S.W.2d 179, 186 (Tex. 1994) (holding that where the record contains substantial evidence to support a disallowance figure of either zero or fifty percent for decisional imprudence, "there is a reasonable basis for the Commission to, in its discretion, select an amount within the range of figures provided by expert testimony of the parties"); *Pioneer Nat. Res. USA, Inc. v. Pub. Util. Comm'n of Tex.*, 303 S.W.3d 363, 373 (Tex. App.—Austin 2009, no pet.) (Expressly rejecting the claim that "Commission cannot apply a capital structure that no single witness or party explicitly proposed.").

<sup>115</sup> *See* PFD at 103-104.

<sup>116</sup> SWEPCO Ex. 38 at 8. In his rebuttal testimony, Mr. D'Ascendis exchanged PNM Resources, Inc. with Evergy, Inc. because of mergers issues affecting his selection criteria.

utility proxy group as Mr. D’Ascendis (also excluding PNM Resources, Inc., but not inserting Evergy, Inc.).<sup>117</sup> CARD witness Woolridge used two utility proxy groups.<sup>118</sup> The first involved twenty seven publicly held electric utilities, and the second proxy group included the same entities as Witness Gorman. Staff Witness Filarowicz developed his own proxy group with his own criteria that involved twenty electric utility companies.<sup>119</sup> The below chart illustrates the average authorized ROEs for the proxy group utilities used in this case:

Proxy Group	Average Authorized ROE <sup>120</sup> of Proxy Group Entities
D’Ascendis Utility Proxy Group	9.51
Gorman & Woolridge (2 <sup>nd</sup> )	9.53
Woolridge (1 <sup>st</sup> )	9.62
Filarowicz	9.61

As you can see, the PFD recommended 9.45% ROE for SWEPCO is approximately 6 to 16 basis points below the average authorized ROE for the entities included in the experts’ proxy groups. These are entities the experts all agree have comparable risk to SWEPCO. The authorized ROEs for the entities included in the experts’ proxy groups are reflective of the average authorized ROEs for all electric utilities since 2017 – 9.56%.<sup>121</sup> Moreover, the average authorized ROEs for vertically integrated electric utilities (like SWEPCO) from January 2017 through Feb 2021 was 9.69%<sup>122</sup> – 24 basis points above the recommended ROE for SWEPCO in this matter.

SWEPCO understands the Commission is not bound by average authorized ROEs. However, this information is directly on point to the requirement of *Hope* and *Bluefield* that

<sup>117</sup> Direct Testimony of Michael P. Gorman, TIEC Ex. 3 at Exhibit MPG-3.

<sup>118</sup> Direct Testimony of J. Randall Woolridge, CARD Ex. 4 at Exhibit JRW-7.

<sup>119</sup> Direct Testimony of Mark Filarowicz, Staff Ex. 1 at Attachment MF-1.

<sup>120</sup> See Direct Testimony of Lisa V. Perry, Walmart Ex. 1 at Exhibit LVP-3. The averages were calculated using the state authorized ROEs (Jan 2017 – Feb 2021) as reported by S&P Global and included in Exhibit LVP-3 of Walmart witness Lisa Perry. The averages reflect the state authorized ROEs for those entities whose parent were included in the proxy groups of the experts.

<sup>121</sup> Walmart Ex. 1 at Exhibit LVP-3.

<sup>122</sup> Walmart Ex. 1 at Exhibit LVP-3.

SWEPCO be allowed to earn a return comparable to its peers. SWEPCO will necessarily compete for utility investment dollars with similarly situated utilities in Texas and across the nation. If the Commission approves a 9.45% ROE for SWEPCO, investors could invest their money elsewhere – with utilities of comparable risk that have higher ROEs.

**The PFD recommended 9.45% ROE does not fully consider the reasonable range of ROEs supported by the expert testimony in this case.**

As stated above, the ALJs determined that a reasonable range for SWEPCO's ROE would be between 9.0% and 9.9%. Consequently, the PFD proposes the midpoint of that range – 9.45%. In making this determination the ALJs made three adjustments to Mr. D'Ascendis' expert testimony to determine the high end of the reasonable range. First, the ALJs concluded that the evidence did not support a size or credit risk adjustment. Second, the ALJs excluded Mr. D'Ascendis' Non-Price Regulated Proxy Group from consideration because, according to the ALJs, the companies in this proxy group did not share comparable risk. Third, the ALJs determined that Mr. D'Ascendis' PRPM risk premium should be given less weight in the overall analysis.

Although SWEPCO disagrees with the ALJs adjustments to Mr. D'Ascendis' recommendation, it understands and respects the ALJs logic in making these determinations. However, even following the ALJs guidance, the reasonable ROE range should be higher on the high end. That is, even excluding the size and credit adjustments, the Non-Price Regulated Proxy Group, and the PRPM analysis from Mr. D'Ascendis' testimony, his recommended range is still 9.94% to 10.56% with a midpoint of 10.25%.<sup>123</sup> It follows then that the reasonable range for SWEPCO's ROE should not be 9% to 9.9%, but instead should be 9% to 10.2% with a recommended midpoint ROE of 9.6%.

**Conclusion**

Based on the foregoing, SWEPCO respectfully requests that the PFD recommended 9.45% ROE be revised and the Commission adopt an ROE of 9.6%, which is in keeping with the average authorized ROEs for other utilities (including fully integrated utilities) with comparable risk and the expert testimony in this case.

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<sup>123</sup> See SWEPCO Ex. 38 at Exhibit DWD-1R.

## VII. EXPENSES

### A. Transmission and Distribution O&M Expenses

#### 6. Allocated Transmission Expenses Related to Retail Behind-the-Meter Generation (Exceptions to FoF Nos. 214, 216-219, and 222-226)

As it has done in past base-rate cases, SWEPCO requested recovery of its Test Year transmission charges from SPP and proposed to allocate those costs at the jurisdictional and class levels based on the demands used by SPP for the billing of the transmission expenses to SWEPCO.<sup>124</sup> The PFD correctly concludes that “SWEPCO’s undisputed evidence that its test-year [Network Integration Transmission Service (NITS)]<sup>125</sup> charges were billed by SPP and paid by SWEPCO is sufficient to demonstrate their reasonableness as a matter of law under the filed rate doctrine.”<sup>126</sup> Nevertheless, the PFD effectively disallows recovery of these reasonable charges by recommending that Eastman’s Texas retail BTMG load be removed when performing the jurisdictional and class allocations of transmission costs.<sup>127</sup> SWEPCO excepts to this recommendation because it violates longstanding principles of cost causation by proposing an arbitrary allocation of incremental transmission costs to jurisdictions and customers that did not cause the costs to be incurred.

SPP allocates the cost of using its transmission system to NITS customers, such as SWEPCO, based on the load ratio share of each customer’s monthly Network Load to the total system load at the time of the monthly system peak.<sup>128</sup> To obtain the data necessary to make this

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<sup>124</sup> The primary dispute regarding SWEPCO’s Test Year SPP charges concerned the inclusion of retail behind-the-meter generation (BTMG) load in SWEPCO’s monthly Network Load reported to SPP and the corresponding increase in SWEPCO’s load ratio share for purposes of SPP’s allocation of transmission costs to its members, including SWEPCO. TIEC and Eastman argued that the inclusion of retail BTMG load is not required by SPP’s FERC approved Open Access Transmission Tariff (OATT) and that any increase in SPP charges to SWEPCO resulting from the inclusion of such load should be disallowed. *See* PFD at 169. SWEPCO disagreed, arguing that SPP has instructed Network Customers to include retail BTMG load in their monthly Network Load calculations and that whether SWEPCO is complying with or SPP is correctly interpreting its OATT is subject to FERC’s exclusive jurisdiction. PFD at 170 and 173. The PFD finds that “FERC has exclusive jurisdiction to resolve disputes involving the interpretation of a FERC-approved tariff, such as SPP’s OATT.” *See* PFD at FoF No. 209.

<sup>125</sup> To serve its retail and wholesale customers, SWEPCO purchases NITS from SPP in accordance with SPP’s FERC-approved OATT. *See* Rebuttal Testimony of C. Richard Ross, SWEPCO Ex. 52 at 4:18-20.

<sup>126</sup> PFD at 194 and FoF No. 212.

<sup>127</sup> PFD at 196 and FoF No. 226.

<sup>128</sup> SWEPCO Ex. 52 at 5:18-20; PFD at FoF No. 195.

allocation, SPP requires NITS customers to submit their monthly Network Load data to SPP.<sup>129</sup>

There is no dispute that during the Test Year:

- SWEPCO included the retail BTMG load of one customer, Eastman, in its Network Load data reported to SPP;
- the inclusion of Eastman's retail BTMG load in SWEPCO's Network Load data increased SWEPCO's load ratio share; and
- SWEPCO's increased load ratio share relative to other SPP NITS customers resulted in a corresponding increase in NITS charges billed to SWEPCO.<sup>130</sup>

These facts establish that Eastman is SWEPCO's only retail BTMG customer whose load could have caused the incremental increase in SWEPCO's Test Year NITS charges. TIEC concedes this fact, stating in its reply brief that "[i]f any customer 'caused' costs relating to SWEPCO's decision to include Eastman's BTMG-load in its SPP network reports, it is Eastman itself."<sup>131</sup> To ignore this fact and remove Eastman's BTMG load from the determinations of the jurisdictional and class allocations of transmission costs is inappropriate because it fails to allocate costs to the jurisdiction with the customer that "caused" the costs.

In support of its recommendation, the PFD finds that SWEPCO treated its retail jurisdictions inconsistently when allocating its SPP charges—adding retail BTMG load to the Texas jurisdictional allocator but not to Louisiana and Arkansas allocators—and that this treatment increases Texas's share of SWEPCO's transmission costs by \$5.7 million, with corresponding reductions to the Arkansas and Louisiana jurisdictions.<sup>132</sup> The PFD further finds that SWEPCO's proposed allocation is unreasonable and results in unreasonably discriminatory rates for Texas customers.<sup>133</sup> The PFD is mistaken.

SWEPCO's proposed jurisdictional allocation of its SPP charges treats SWEPCO's retail jurisdictions in a fair and consistent manner. SWEPCO added Eastman's retail BTMG load to the Texas jurisdictional allocator because: (1) Eastman is a Texas customer, and (2) Eastman's load was reported to and used by SPP when allocating SWEPCO its share of NITS costs. SWEPCO

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<sup>129</sup> Rebuttal Testimony of Charles J. Locke, SWEPCO Ex. 51 at 5:1-3; PFD at FoF No. 196.

<sup>130</sup> See PFD at 168-69.

<sup>131</sup> TIEC Reply Brief at 43.

<sup>132</sup> PFD at FoF Nos. 216 and 222.

<sup>133</sup> PFD at FoF No. 223.

did not add the retail BTMG load of Louisiana and Arkansas customers to the jurisdictions' respective allocators because this load was not reported to or used by SPP when allocating NITS charges to SWEPCO. Arbitrarily including Arkansas and Louisiana retail BTMG load, as the PFD implies SWEPCO should have done, would have resulted in inconsistent treatment and a jurisdictional allocation of a share of the incremental NITS charges caused by reporting Eastman's retail BTMG load to jurisdictions and customers that did not cause those costs to be incurred.

The PFD appears to base its arbitrary recommendation to remove Eastman's retail BTMG load from the Texas jurisdictional allocator, at least in part, on SWEPCO's decision to include only Eastman retail BTMG load in its Network Load calculations. But SWEPCO explained that it:

- initiated the data reporting changes beginning with the loads served using the Eastman BTMG due to the size of Eastman's facility, its impact on day-to-day SPP real-time operations, and the fact that not all of Eastman's load is truly behind the meter;<sup>134</sup>
- has not included in its Network Load report to SPP other retail BTMG loads because the generation and associated load are not synchronized to the SPP system or there is a concomitant loss of load with the loss of generation at the site;<sup>135</sup>
- is continuing to review and, as appropriate, will update its data reporting procedures for SPP transmission billing.<sup>136</sup>

SWEPCO further confirmed that the alleged harm of SWEPCO's reporting practices, if any, is immaterial because the relative size of the Eastman facility makes it larger than all other potential BTMG combined in SWEPCO's Texas jurisdiction and, in fact, across its entire service territory.<sup>137</sup>

Nevertheless, even assuming SWEPCO had reported its Arkansas and Louisiana customers' retail BTMG load to SPP, it would not have affected SWEPCO's Texas jurisdictional share of the NITS charges at issue here. Rather, reporting this load to SPP would have increased SWEPCO's load ratio share relative to other NITS customers in SPP and, in turn, resulted in a corresponding increase total NITS charges billed to SWEPCO. And while in that scenario, SWEPCO would have appropriately included the Arkansas and Louisiana retail BTMG load reported to SPP when determining the jurisdictions' respective allocations of SWEPCO's

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<sup>134</sup> SWEPCO Ex. 52 12:15-19; Tr. at 631:9-14 (Al-Jabir Cross) (May 21, 2021).

<sup>135</sup> SWEPCO Ex. 52 at 12:10-12.

<sup>136</sup> SWEPCO Ex. 52 at 12:12-14.

<sup>137</sup> SWEPCO Ex. 52 at 12:19-21.

increased NITS charges, doing so would have simply allocated the increased costs to SWEPCO's Arkansas and Louisiana jurisdictions. It would not have lowered the jurisdictional allocation of costs to SWEPCO's Texas jurisdiction.

Moreover, the appropriateness of SWEPCO's decision to include only Eastman's retail BTMG load in its Network Load calculations reported to SPP does not bear on how SWEPCO should allocate the charges actually billed to SWEPCO by SPP among SWEPCO's jurisdictions. Instead, the decision concerns SWEPCO's compliance with the FERC-approved SPP OATT and the total SPP charges billed to SWEPCO in accordance with the OATT. And there is no dispute that FERC has exclusive jurisdiction to address these issues. If any affected person believes that SWEPCO's Network Load reporting practices are resulting in unreasonable transmission charges in violation of the SPP OATT, they can file a complaint with FERC.<sup>138</sup>

The PFD also suggests that SWEPCO's jurisdictional allocation method is inconsistent with how SWEPCO has allocated transmission costs in past cases and that SWEPCO failed to explain why including Eastman's retail BTMG load when jurisdictionally allocating transmission costs is appropriate.<sup>139</sup> Both suggestions are wrong. First, SWEPCO's proposed allocation of its SPP charges is consistent with how these costs were allocated in SWEPCO's last rate case, Docket No. 46449. In Docket No. 46449, SWEPCO allocated its SPP charges among its jurisdictions based on the load reported to and used by SPP for allocating NITS charges to SWEPCO. That is exactly what SWEPCO proposed in this case. SWEPCO did not add in retail BTMG load when performing the jurisdictional allocation of SPP charges in Docket No. 46449 because SWEPCO did not report any retail BTMG load to SPP for purposes of SPP's billing of NITS charges to SWEPCO during the Docket No. 46449 test year, which was the twelve-month period ending June 30, 2016. SWEPCO began including retail BTMG load in its calculation of Network Load reported to SPP for NITS billing in October 2018.<sup>140</sup> Second, SWEPCO witness John O. Aaron unequivocally explained why it is appropriate to include Eastman's retail BTMG load when allocating SWEPCO's SPP charges among its jurisdictions. Specifically, Mr. Aaron testified that

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<sup>138</sup> 16 U.S.C. §§ 824e, 825e; 18 C.F.R. § 385.206(a) ("Any person may file a complaint seeking Commission action against any other person alleged to be in contravention or violation of any statute, rule, order, or other law administered by the Commission, or for any other alleged wrong over which the Commission may have jurisdiction.").

<sup>139</sup> PFD at 195 and FoF No. 219.

<sup>140</sup> PFD at FoF No. 197.

if Eastman’s retail BTMG load “is removed from the Texas jurisdictional allocations, the costs incurred to provide service to SWEPCO’s Texas jurisdiction would be inappropriately shifted to SWEPCO’s other jurisdictions”—i.e., the removal would result in an allocation that violates cost causation.<sup>141</sup>

Finally, as noted above, the removal of Eastman’s retail BTMG load from the jurisdictional allocation theoretically shifts the increase in Test Year NITS charges to SWEPCO’s customers in its other jurisdictions. The reality, however, is that these costs are likely trapped because SWEPCO has filed rate cases in both of its retail jurisdictions in which SWEPCO has proposed allocating its SPP charges using the same method proposed here—i.e., using the load reported to and used by SPP when billing the charges to SWEPCO. SWEPCO does not expect the Arkansas and Louisiana regulators to ignore cost causation and permit a shifting of costs caused by a Texas retail customer to customers in their respective states.

SWEPCO requests that the Commission replace FoF Nos. Nos. 214, 216-219, and 222-226 with the following findings:

- Transmission costs charged to SWEPCO by SPP for retail BTMG Texas load were properly allocated to the Texas retail jurisdiction because they were based on the demands used by SPP for the billing of transmission expenses incurred by SWEPCO.
- If retail BTMG costs are removed from the Texas jurisdictional allocations, the costs incurred to provide service to SWEPCO’s Texas jurisdiction would be inappropriately shifted to SWEPCO’s other jurisdictions.
- SWEPCO’s proposals to allocate transmission costs at both the jurisdictional and class levels are reasonable, necessary, non-discriminatory, and consistent with cost-causation.

## **H. Taxes Other Than Income Tax**

### **1. Ad Valorem (Property) Taxes (Exceptions to FoF Nos. 180-184)**

The sole remaining contested issue regarding property taxes is the calculation of an effective property tax rate to be applied to SWEPCO’s adjusted rate base in determining the amount of property taxes to include in SWEPCO’s cost of service. The PFD would erroneously have the Commission assign an effective tax rate to Texas customers that is lower than what

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<sup>141</sup> See Rebuttal Testimony of John O. Aaron, SWEPCO Ex. 54 at 1:18-2:9.

SWEPCO is actually incurring and lower than the effective tax rate assigned to SWEPCO's customers in Louisiana and Arkansas. The PFD's recommendation on this question is based on a false statement made in Staff's initial brief (a statement not made by Staff's witness). The ALJs appear to have overlooked that SWEPCO conclusively disproved this false statement in its reply brief, relying on record evidence. SWEPCO respectfully requests that Commission Staff correct its misstatement and the Commission reject the PFD's findings regarding the calculation of an effective property tax rate in this case.

### **Background**

Consistent with Commission precedent, SWEPCO calculates its cost of service ad valorem (property) tax expense by applying an effective property tax rate to SWEPCO's pro forma net rate base at the end of the test year. Property tax expense incurred in a year reflects the taxes charged based on property values at the beginning of the year (*e.g.*, ad valorem tax expense for calendar year 2019 is based on property values at January 1, 2019). The actual, historical effective property tax rate applied to the adjusted test-year rate base synchronizes property tax expense with the property included in rate base that will generate the associated tax.<sup>142</sup> This method of calculating property taxes is the same SWEPCO used and the Commission approved in SWEPCO's most recently completed rate case, Docket No. 46449.<sup>143</sup> The PFD adopted in Docket No. 46449 demonstrates this fact:

Ad valorem taxes are calculated by applying an effective ad valorem tax rate to SWEPCO's *pro forma* plant in service at the end of the test year. Ad valorem tax expense recorded in a given year reflects the taxes charged based on property values at the beginning of the year (*e.g.*, ad valorem tax expense for the calendar year 2015 is based on plant values at January 1, 2015). The Company used the 2015 tax year, which was the last tax year for which a known and measurable amount of ad valorem tax was paid and accounted for. SWEPCO then calculated the effective ad valorem tax rate and synchronized the ad valorem tax expense with the plant investments included in rate base that generated the associated tax.<sup>144</sup>

The rate base to which the effective tax rate is applied must be adjusted to reflect Texas jurisdictional rate base. SWEPCO is a multi-jurisdictional utility, operating in Texas, Louisiana, and Arkansas, and its books are a hybrid of each state's unique decisions. For determining Texas'

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<sup>142</sup> SWEPCO Ex. 6 at 29:16-30:2.

<sup>143</sup> *See* Docket No. 46449, PFD at 290-91 (Sept. 22, 2017).

<sup>144</sup> Docket No. 46449, PFD at 290-91 (emphasis in original).

rate base, SWEPCO's books are adjusted to recognize Texas specific decisions. For example, accumulated depreciation is restated to recognize Texas approved depreciation rates. In this case, Texas depreciation rates over time have been lower than the average. Therefore, on a Texas basis, the undepreciated value of SWEPCO's property is higher than in the other two states. The Commission has approved this approach. In Docket No. 46449, the use of the "Texas-only" adjustment to rate base was challenged in the calculation of accumulated depreciation. The Commission found:

175. It was reasonable for SWEPCO to adjust its accumulated-depreciation-account balance downward by \$112,501,487 when conducting its depreciation study to consider only the depreciation rates that the Commission has ordered for SWEPCO and not the depreciation rates ordered by other jurisdictions in which SWEPCO operates.<sup>145</sup>

#### **Calculation of the Effective Tax Rate**

The calculation of the effective property tax rate to apply to the Texas rate base must reflect the actual property taxes paid in a historical year matched with the actual book value (unadjusted) of property that generated those taxes. In this case, the actual property taxes paid in 2019 were matched with the actual book value (unadjusted) of property in 2019 that generated those taxes. In calculating the effective tax rate, SWEPCO *does not* adjust the historical value of property to state it on a Texas-only basis. To do so would misstate the actual property tax rate being incurred by SWEPCO, which is based on the actual composite book value of SWEPCO's property. This calculation results in an effective tax rate that is identical for each of SWEPCO's three jurisdictions. This makes sense, given that each taxing authority taxes SWEPCO's property under its jurisdiction with a single rate. If Texas-only jurisdictional adjustments were made to the 2019 value of property on which the 2019 property taxes were calculated, it would reduce the effective tax rate for Texas customers below that for Louisiana and Arkansas customers. Neither Staff nor the PFD explain why Texas customers should be charged a lower effective tax rate than customers in Louisiana and Arkansas.

The testimony of Staff's own witness confirms that, in calculating the effective tax rate, SWEPCO does not adjust in any way the historical property value that generated the historical property taxes:

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<sup>145</sup> Docket No. 46449, Order on Rehearing at FoF No. 175.

SWEPCO calculation of its requested ad valorem tax expense begins with an amount of \$6,315,734,214 that it identifies as its January 1, 2019 net electric plant subject to ad valorem tax. SWEPCO then indicates that \$63,325,856 of ad valorem taxes were paid for the 2019 tax year. SWEPCO divides the \$63,325,856 of 2019 ad valorem taxes paid by the \$6,315,734,214 plant balance identified by SWEPCO as the January 1, 2019 balance subject to ad valorem tax to determine its effective ad valorem tax rate of 1.00266816%.<sup>146</sup>

Despite the fact that SWEPCO makes no jurisdictional adjustments in its effective tax rate calculation, the PFD would have the Commission find:

180. SWEPCO's requested effective ad valorem tax rate excludes Texas jurisdictional differences that would decrease the effective tax rate but includes Texas jurisdictional differences that increase the effective rate.<sup>147</sup>

There is no truth to this proposed finding. Here, the PFD is simply repeating an erroneous allegation contained in Staff's initial brief. In its initial brief, Staff made this false allegation never made by its witness:

SWEPCO itself includes Texas jurisdictional differences in the calculation of its effective tax rate that serve to reduce the balance of plant subject to the tax (and therefore increase the effective tax rate) such as the Texas jurisdictional Turk imprudence disallowance, Texas VM write-offs, and capitalized incentive compensation, among others. SWEPCO, as the party with the burden of proof, has provided no evidence or justification for why it is appropriate to include the Texas jurisdictional differences that increase the effective rate while arguing against including Texas jurisdictional differences that decrease the effective rate.<sup>148</sup>

In other words, Staff in its initial brief (and now the PFD) accuses SWEPCO of making Texas-only adjustments in calculating the effective property tax rate, but only those Texas-only adjustments that would result in an increase in the effective rate. That allegation is false. The SWEPCO workpaper cited by Staff in its initial brief disproves Staff's allegation. W/P Schedule A-3.13.1<sup>149</sup> clearly shows that the calculation of the effective tax rate, shown on lines 1 through 3, is simply the actual 2019 property taxes incurred by SWEPCO divided by the unadjusted 2019 rate base, just as described above. The Texas-only adjustments referenced above in the initial brief of Staff, as shown on W/P Schedule A-3.13.1 line 10, are applied to the Test Year rate base to

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<sup>146</sup> Staff Ex. 3 at 48:10-17.

<sup>147</sup> PFD at FoF No. 180.

<sup>148</sup> Staff Initial Brief at 65 (footnote omitted).

<sup>149</sup> Staff Ex. 3 at Attachment RS-52; Rate Filing Package, SWEPCO Ex. 1 at WP A-3.13.1 (Ad Valorem).

which the effective tax rate is applied – “03-31-2020 Plant Balance Subject To Ad valorem Tax” – just as described above, consistent with Commission precedent. It should also be noted that these Texas-only adjustments to Test Year Texas rate base serve to *lower* the rate base to which the effective tax rate is applied, thereby *lowering* cost of service property taxes, not raising them, as is alleged in proposed FoF No. 180.

On this subject, the PFD states, “although SWEPCO raises concerns about removing Texas-only jurisdictional adjustments, SWEPCO failed to explain why including some but not other Texas-only jurisdictional adjustments is appropriate when calculating its effective tax rate.”<sup>150</sup> SWEPCO did not provide this explanation, because SWEPCO made no such adjustments in its calculation of the effective tax rate. Instead, as discussed above, SWEPCO proved with record evidence that no such adjustments were made or were proper.

SWEPCO requests that the Commission replace Findings of Fact Nos. 180-184 with the following:

- SWEPCO calculates ad valorem tax expense by applying an effective ad valorem tax rate to SWEPCO’s pro forma net rate base at the end of the Test Year.
- The effective ad valorem tax rate synchronizes ad valorem tax expense with the plant investments included in rate base that generates the associated tax.
- This method of calculating ad valorem taxes is the same that was used by SWEPCO and approved by the Commission in SWEPCO’s previous rate case, Docket No. 46449.

## **X. REVENUE DISTRIBUTION AND RATE DESIGN**

### **B. Rate Design and Tariff Changes**

#### **1. Staff’s Issues Regarding the GS Rate Schedule and Customer Migration**

##### **a. The GS Rate Schedule 50 kW Maximum Demand (Exceptions to FoF No. 278)**

SWEPCO takes exception to the PFD’s adoption of Staff witness Adrian Narvaez’s position that SWEPCO’s proposal to remove the 50kW maximum demand restriction from its GS tariff should be rejected. Mr. Narvaez opposed this change to the GS tariff based on his view that it would allow for customer migration from the LP class to the GS class, and thus potentially result

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<sup>150</sup> PFD at 252.

in rates that are insufficient to recover the costs to serve those classes. However, as SWEPCO witness Ms. Jackson explained on rebuttal, the new structure of the GS rate class (as well that of the LP rate class) is reasonably intended to create a rate schedule for customers based on their energy and load requirements (kWh usage, demand requirements, seasonality, time-of-use and load factor). Further, the structures are based on test-year adjusted billing determinants for each class.<sup>151</sup> Migration between the classes can and will occur, but this is normal and typical customer behavior.

The PFD finds that SWEPCO's proposed removal of the GS tariff demand requirement restriction would "blur distinctions" between the GS and LP rate schedules, noting that this is the basis for Staff's opposition to allowing customers the choice to take service under multiple tariffs. But the PFD is inconsistent in its findings regarding the proposed removal of the GS demand requirement restriction and its determination regarding Staff's request for the Commission to order SWEPCO to eliminate the potential for customer migration between tariffs. The PFD poses several questions and concerns regarding customers' ability to choose service under multiple rate schedules but ultimately finds the issue "not well developed" and thus does not recommend elimination of migration between classes.

Inexplicably, as to the proposed GS tariff change, the PFD purports to answer those questions and determines, without any supporting evidence, that the removal of the GS demand requirement restriction "could result in a flood away from the LP class into the GS class."<sup>152</sup> The PFD also does not explain why the proposed change to the GS tariff that offers customers an additional rate option is any different from previous rate options offered to SWEPCO customers that the Commission has approved in the past.<sup>153</sup> The new GS tariff proposal was designed with two options, a kWh (energy)-only option and a demand (kW)-based option, removing the 50 kW maximum demand requirement. The kWh-only option has a higher per kWh rate than the demand rate, but does not include a kW charge. The kWh-only rate may be a better option for lower-load factor customers.<sup>154</sup> For higher load factor customers, the demand charge has been revised to

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<sup>151</sup> Rebuttal Testimony of Jennifer Jackson, SWEPCO Ex. 55 at 10.

<sup>152</sup> PFD at 304.

<sup>153</sup> SWEPCO Ex. 55 at 10:1-11:6.

<sup>154</sup> Direct Testimony of Jennifer L. Jackson, SWEPCO Ex. 32 at 18:1-8.

include a charge for *each* kW of billing demand to replace the current charge for demand in excess of 10 kW.<sup>155</sup> Disallowing the removal of the 50 kW demand cap fundamentally changes this rate design. SWEPCO designed the proposed GS tariff to benefit low load factor commercial customers with higher demand requirements who see high bill impacts under the LP schedule and have thus been requesting a rate design better suited to their needs. The Commission should approve this change to the GS tariff.

SWEPCO requests that the Commission replace Finding of Fact No. 278 with the following finding:

- The new structure of the GS and Lighting and Power (LP) rate classes is appropriately and reasonably designed to create a rate schedule for customers based on their energy and load requirements.
- 3. TIEC's LLP Rate Schedule and Reactive Power Issues (Exceptions to FoF Nos. 287-288)**

SWEPCO takes exception to the PFD's finding that SWEPCO did not justify its proposal to increase the reactive demand charge in the Large Lighting & Power (LLP) rate schedule. As explained in the rebuttal testimony of SWEPCO witness Jennifer Jackson, the reactive demand charge "is encompassed within and is part of the overall increase."<sup>156</sup> There is no evidence in the record to the contrary. Given this uncontroverted evidence, the claim by TIEC witness Mr. Pollock that there is no support for the proposed increase falls flat. Although he asserts there should be some type of undefined study done to support the cost basis for the increase, there is no such requirement. Therefore, it was reasonable for SWEPCO to use the system average increase as the basis for the increase in the reactive demand charge. As the record evidence shows, and contrary to the PFD's finding, SWEPCO did not merely assume that the increase in the charge was the same as the system average increase.

Importantly, SWEPCO customers that are billed reactive (or kVAR) charges are customers taking service on the Supplementary, Backup, Maintenance, and As-Available Standby Power Service rate schedule that have reactive demand issues. If the Commission adopts the ALJs' recommendation and does not approve the proposed increase in the reactive demand charge, the change in the revenue requirement that coincides with the kVAR charges will have to be spread

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<sup>155</sup> SWEPCO Ex. 32 at 18:8-10.

<sup>156</sup> SWEPCO Ex. 55 at 14:22-15:2.

out to the demand and energy charges for recovery. This amount totals over \$100,000 for the Lighting & Power (LP) class and the Large Lighting & Power (LLP) classes combined.<sup>157</sup> In other words, if the reactive demand charge increase sought by SWEPCO is denied, other customers that do not have kVAR issues will nevertheless be paying for those charges. Significantly, SWEPCO proposed increasing its charge for highly fluctuating load (shown on Schedule Q-7 Proof of Revenue Statement as “Additional Transformer Cap”) using the same basis as the proposed increase for the reactive demand charge, and neither TIEC nor any other party challenged or opposed that rate increase for any alleged lack of support.

Given the uncontroverted evidence that the reactive demand charge is part of the overall increase in costs shown through SWEPCO’s cost-of-service study, and the reasonableness of using the system average increase as the basis for the proposed increase in the kVAR charge, SWEPCO respectfully requests the Commission approve the proposed increase. Otherwise, customers who are not responsible for creating the reactive demand costs will be forced to pay those costs through their rates.

SWEPCO requests that the Commission replace Findings of Fact Nos. 287 and 288 with the following findings:

- The reactive demand charge is encompassed within and is part of the overall cost increase.
- Because the reactive demand charge can apply to multiple rate classes, SWEPCO’s use of the system average increase to update the reactive demand charge was reasonable.

#### **XIV. CONCLUSION**

SWEPCO requests the Commission reject the portions of the PFD discussed in these Exceptions, and substitute findings and conclusions consistent with law, Commission rules, sound Commission policy, and the evidentiary record.

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<sup>157</sup> See Schedule Q-7, Proof of Revenue Statement, LLP Transmission and LP Primary tabs.

Respectfully submitted,

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**ATTORNEYS FOR SOUTHWESTERN  
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**CERTIFICATE OF SERVICE**

I certify that, unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on October 7, 2021, in accordance with the Second Order Suspending Rules issued in Project No. 50664 and Order No. 1 in this matter.

A handwritten signature in black ink, appearing to read 'William Coe', is written over a horizontal line.

William Coe